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MONITORING COUNTRY PROGRESS
IN CENTRAL AND EASTERN EUROPE
& THE NEW INDEPENDENT STATES

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EXECUTIVE SUMMARY

I. Introduction

The programs of U.S. assistance to Central and Eastern Europe (CEE) and to the New Independent States (NIS) of the former Soviet Union have been envisioned, since their inception, as short-term programs to jump start the countries of this strategically critical region on their way to political and economic transitions. It is essential, therefore, to monitor not only the impact of the U.S. assistance programs, but also the progress of the countries more generally to determine whether continued assistance is necessary or justified. This paper presents USAID/ENI's system for monitoring country progress with a focus on developing criteria towards graduation from USAID assistance.

II. Methodology

Country progress is analyzed in a sequence of steps for twenty-five countries of the region. First, we look at the progress towards economic reforms and democratization. The promotion of both are the two pillars of USAID's program in the region. Progress on both fronts must reach a certain threshold before we can begin to consider graduation.

Next, we look at indications of sustainability; that is, macroeconomic performance and social conditions. Economic reforms need to translate into solid macroeconomic performance if they are to be sustained. Trends in social conditions need to be tracked as well to give us a pulse on the possibilities of economic and democratic "reform fatigue" as well as fiscal sustainability.

For most indicators, proposed graduation benchmarks are assigned. Failure of a country to meet a benchmark is intended to signal a "yellow flag" in the mind of the analyst; an aspect that may need to be examined more thoroughly if graduation is being considered on the basis of other evidence.

The indicators are drawn from standard, well-established data sources that are external to USAID. The primary sources are the EBRD, Freedom House, and the World Bank. Supplemental sources include the IMF, and the UNDP, and the Bureau of Census.

An important step of the process is the holding of annual reviews--one for CEE, one for the NIS--of the data prior to the spring USAID program reviews. These reviews are to serve as a

reality check on the data and our interpretation of it.

III. Analysis

The *Summary Table* below provides an overall picture of the current status of the economic policy reforms and democratic freedoms. *Figure 1* portrays these data to help ascertain how and to what extent economic policy and democratization might be linked.

Salient observations. Progress in economic and democratic reforms in CEE is much greater than in the NIS. The gap is greatest in democratic reforms. Of the CEE countries assessed (this excludes Bosnia and Serbia), only Croatia lags behind some of the NIS in this domain. Five CEE countries (the Czech Republic, Hungary, Poland, Slovenia, and Lithuania) have attained a level of democratic freedom comparable to that which exists in many OECD countries. In striking contrast, political rights and civil liberties in three NIS (Uzbekistan, Tajikistan, Turkmenistan) in 1995 were as few as anywhere in the world.

The top eight leading reformers in terms of economic policy are all CEE countries; the bottom eight are all NIS. While the progress of economic reforms ranges widely between these two groups, even the leaders have far to go, particularly in terms of institutional capability, relative to standards in the industrial market economies.

Only Belarus experienced a net deterioration in economic policy reforms in the past three years. In general, recent progress in economic reforms has been the most evident among those countries at an intermediate stage in the transition process. Countries at a more advanced transition stage have tended to make less progress in large part because the remaining reforms are the most difficult and take the most time to implement and enforce.

Six countries experienced a net deterioration in both political and civil liberties from 1991 to 1995. All are NIS: Uzbekistan, Turkmenistan, Tajikistan, Azerbaijan, Kazakstan, and Belarus.

There is a close correspondence between the development of economic reforms and democratization. Progress in both areas is the most advanced in the Czech Republic, Hungary, and Poland. Turkmenistan, Tajikistan, Azerbaijan, Belarus, and Uzbekistan, rank towards the bottom in both areas.

Many contrasts between CEE countries and the NIS in terms of macroeconomic performance and social conditions mirror the often-times stark differences in economic reforms and democratization. These include:

- (a) Robust economic growth is occurring in CEE (four percent in the past three years). The economies of the NIS are still on balance contracting (eight percent decline from 1994-1996).
- (b) In CEE, only the economies of Slovenia and Bulgaria have a private sector less than fifty percent of GDP. In the NIS, only the economy of Russia has a private sector greater than fifty percent of GDP.
- (c) Income inequality and poverty tend to be much greater in the NIS than in CEE; the poverty rate may be close to forty percent in the NIS relative to less than twenty percent in CEE.
- (d) Life expectancy in CEE increased slightly from 1991 to 1994. In the NIS, it decreased by three percent in this time period.

Finally, an application of the decision tree methodology in concert with the proposed graduation benchmarks leads to the conclusion that there is likely a handful of current leading contenders for graduation from USAID assistance in CEE.

IV. Concluding Remarks

Making appropriate decisions on the magnitude and duration of U.S. assistance to countries of the ENI region requires consideration of much more than country progress and need. Other key factors include:

- (a) the strategic importance of the country to the U.S.;
- (b) the importance of the recipient country to U.S. citizens;
- (c) the effectiveness of particular assistance activities.

The first two factors are considered by USAID and by the State Department-based Coordinators for U.S. Assistance to both CEE and the NIS in setting annual assistance levels for each country. The effectiveness of the assistance is assessed through the annual collection of data on established performance targets and through occasional project evaluations and sectoral impact evaluations.

Within this broader policy context, USAID will collect, analyze, and report on the country performance indicators semi-annually. These data will be provided to the State Department-based Coordinators for U.S. Assistance to CEE and the NIS and discussed with them, along with assessments of the other three factors

listed above, when country planning levels are determined each winter. Particular country levels will likely be shaped in part by whether a given country falls into one of three categories, based on the analysis of country performance indicators:

- (a) Countries ranked near the top of the list are obvious candidates for earlier "graduation".
- (b) Countries near the bottom of the list may fall into one of three contrasting categories: (i) those where assistance is least likely to be effective, in which case it may make sense to close those programs down altogether or to keep highly targeted funding at minimal levels until their commitment to reform increases; (ii) those where reform now appears likely but requires greater resources; or (iii) those which possess characteristics that match well with the Agency's priorities for sustainable development programs.
- (c) Countries in the middle of the list are likely candidates for continuing programs through existing funding mechanisms, as long as the assistance is effective and Congress continues to appropriate funds for this purpose. From these countries we would expect to see the next group of candidates to graduate.

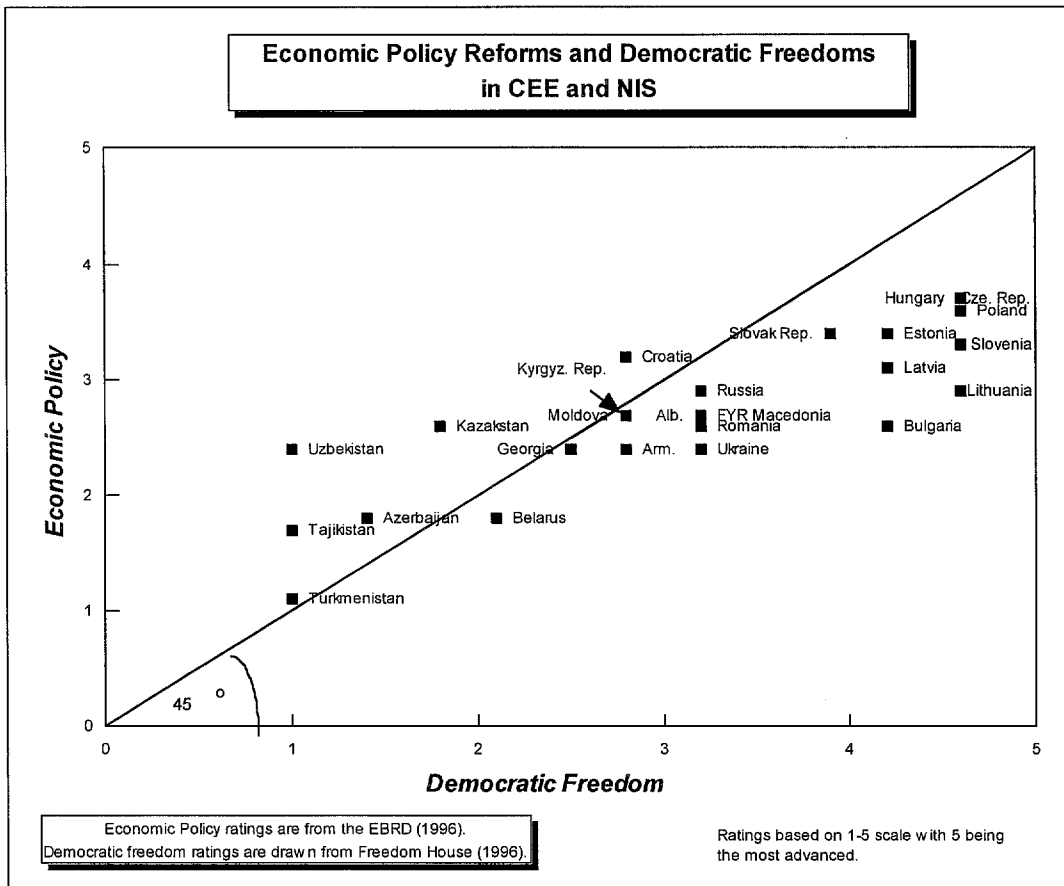
Finally, country progress indicators can play a role in shaping not just the duration and size of USAID's program in a particular country, but, in broad strokes, the nature of the program as well. Are the mission's basic priorities appropriate?

Summary Table. Economic Policy Reforms and Democratic Freedoms in CEE & NIS¹

CEE & NIS	Economic Policy		Democratic Freedoms		
	Rating	Ranking	Rating	Ranking	
Czech Rep.	3.7	1	Czech Rep.	4.6	1
Hungary	3.7	1	Hungary	4.6	1
Poland	3.6	3	Poland	4.6	1
Estonia	3.4	4	Slovenia	4.6	1
Slovak Rep.	3.4	4	Lithuania	4.6	1
Slovenia	3.3	6	Estonia	4.2	6
Croatia	3.2	7	Latvia	4.2	6
Latvia	3.1	8	Bulgaria	4.2	6
Lithuania	2.9	9	Slovak Rep.	3.9	9
Russia	2.9	9	Romania	3.2	10
Albania	2.7	11	Albania	3.2	10
Macedonia	2.7	11	Macedonia	3.2	10
Moldova	2.7	11	Russia	3.2	10
Kyrgyz Rep.	2.7	11	Ukraine	3.2	10
Bulgaria	2.6	15	Croatia	2.8	15
Romania	2.6	15	Moldova	2.8	15
Kazakstan	2.6	15	Armenia	2.8	15
Armenia	2.4	18	Kyrgyz Rep.	2.8	15
Georgia	2.4	18	Georgia	2.5	19
Ukraine	2.4	18	Belarus	2.1	20
Uzbekistan	2.4	18	Kazakstan	1.8	21
Belarus	1.8	22	Azerbaijan	1.4	22
Azerbaijan	1.8	22	Uzbekistan	1.0	23
Tajikistan	1.7	24	Tajikistan	1.0	23
Turkmenistan	1.1	25	Turkmenistan	1.0	23
Averages:					
CEE & NIS	2.8		3.1		
CEE	3.2		4.1		
NIS	2.6		2.7		
EU	5.0		4.8		
OECD	--		4.6		

¹Economic Policy ratings are from EBRD, *Transition Report 1996* (November 1996); democracy ratings are drawn from Freedom House, *Freedom in the World, 1995-1996* (March 1996). On a 1-5 scale with 5 being the most advanced. All regional averages in this report are population-weighted. Elaboration of rating schemes is provided in *Appendix I*.

Figure 1



I. Introduction

The programs of U.S. assistance to Central and Eastern Europe (CEE) and to the New Independent States (NIS) of the former Soviet Union have been envisioned, since their inception, as short-term programs to jump start the countries of this strategically critical region on their way to political and economic transitions. The objective is to help move these countries far enough along the road to becoming market-based democracies that they can complete the journey themselves.

It is, therefore, essential to monitor both the impact of the U.S. assistance programs themselves to maximize their effectiveness (*program impact monitoring*), as well as the progress of the countries more generally to determine whether continued assistance is necessary or justified (*country progress monitoring*). Program impact monitoring is done through a system of setting results targets and annually monitoring progress toward them and through less frequent special field evaluations. This paper presents USAID/ENI's system for monitoring country progress in twenty-five countries of the region.¹

Country progress monitoring is done in part to determine whether the assistance program can be terminated either because: (a) the country is well launched on its way to a successful transition and cessation of assistance will no longer jeopardize that transition (i.e., graduation); or (b) the country is making so little progress that significant resources will have little impact. Monitoring is done semi-annually and results are shared with the State Department-based Coordinators for U.S. Assistance to each of the two regions. The Coordinators are charged with, among other things, determining the magnitude and duration of these transition assistance programs.

Section II below highlights the methodology. This is followed in Section III by analyses in each of the major areas examined: (a) economic policy reforms; (b) democratization; (c) macro-economic performance; and (d) social conditions. Section IV concludes. *Appendix I* elaborates on the rating schemes of the economic policy reform and democratization indicators. *Appendix II* provides a data set of available comparable indicators for select countries outside the region.

¹Bosnia and Serbia are not included in large part because much of the data are not available. It is hoped that future *Monitoring Country Progress* reports will be able to include them.

II. Methodology

Market-oriented reforms and democratization are the two pillars of USAID's program in the ENI region.² The challenge of this analysis thus is essentially to make assessments of the progress on both fronts, with a particular focus on the sustainability of reforms.

Country progress is hence analyzed in a sequence of steps drawing from standard, well-established data sources that are external to USAID. First, we look at the progress towards economic reforms and democratization. Progress on both fronts must reach a certain threshold before we can begin to consider graduation.

Economic policy reforms are assessed by drawing from EBRD's rating scheme of nine transition policy indicators. Progress in democratic freedoms is determined from Freedom House's rating of civil liberties and political rights.³

Next, we look at indications of sustainability. Economic reforms need to translate into solid macroeconomic performance. If the implementation of economic policies is determined to be sufficient in a particular country and yet the economy is performing poorly, then they are not there yet. We might expect improved performance to kick in with a lag. But evidence of good macroeconomic performance would give us more confidence that the reformed economy is self-sustaining.

²USAID assistance to ENI countries is funded through the Support for East European Democracy Act (SEED) and the Freedom Support Act (FSA), the latter applying to the NIS. The SEED Act has two goals: the promotion of democracy and a market-oriented economy. The FSA objectives are broader in scope, including the transition goals of the SEED Act as well as those focused more directly on humanitarian, social, environmental, and trade and investment conditions.

³The Freedom House data come from the annual *Freedom in the World* as well as a study commissioned by USAID/ENI/DG, *Nations in Transit* (July 1995). As a follow-on to the latter, Freedom House is scheduled to deliver to USAID by March 1997 a similar study which, however, will further disaggregate the data. In particular, one-to-seven ratings will be provided for twenty-five countries in seven categories: (1) political process; (2) civil society; (3) independent media; (4) rule of law; (5) governance and public administration (with a focus on local governance); (6) privatization and state sector reform; and (7) economic reform (including an emphasis on the fiscal system and the energy sector).

Furthermore, it is important to underscore that acceptable progress in the reforms must precede good macroeconomic performance. A cross-country snapshot might show one economy outperforming another in part because painful reforms have been avoided in the former. Yet, this is hardly sustainable.

The macroeconomic performance indicators also provide a check on the comprehensiveness of the economic reform indicators. For example, fiscal reform--or, more broadly, the role of the state in the provision of social services--is likely not adequately addressed in the current mix of economic reform indicators. Yet, insufficient fiscal reform is likely to surface in the form of bloated fiscal deficits, and this is being tracked as an economic performance indicator.

Another means to measure the sustainability of both economic and political reforms is to assess trends in social conditions. This is largely the concern of "reform fatigue." The populace may not continue to support difficult reforms if the standard of living for many declines drastically. It may not be good enough, in other words, to have sound economic policies in place, solid macroeconomic performance, and extensive political and civil liberties, if a significant proportion of the population is losing out on balance.

Trends in social conditions also link to fiscal sustainability. Deteriorating social conditions may have a significant impact on social expenditures. Similarly, demographic changes may have substantial repercussions on pension systems.

For most indicators, proposed graduation benchmarks are assigned. Some are more arbitrary than others and need to be held to debate. Should a country fail to meet a benchmark, this should signal a "yellow flag" in the mind of the analyst; an aspect that may need to be examined more thoroughly if graduation is being considered on the basis of other evidence. The number of benchmarks a country needs to achieve should vary according to context.

An important step of the process is the soliciting of expert opinion to serve as a reality check on the data and our interpretation of it. Area specialists will be invited to participate in annual reviews--one for CEE, one for the NIS--of the country progress data prior to USAID's spring program review.

Finally, it merits explicitly recognizing that what is occurring in the region is unprecedented, and that there is little if any theoretical and/or empirical basis for devising precise "thresholds of irreversibility" and estimates of sustainability of reforms. Further, it is reasonable to assume that there is more than one acceptable transition route, or, what may amount to the same, many possible varieties of sustainable market-oriented

democracies. This exercise, in short, is likely to be as much art as it is science, and it is important to place the results in this context.

III. Analysis

A. Economic Policy Reforms

Progress towards economic policy reforms is assessed from indicators drawn from the EBRD's annual *Transition Report*. Sufficient progress must entail both an adequate threshold of reform as well as a favorable trend over time; that is, no significant policy backsliding.

Nine indicators are taken directly from EBRD's *Transition Report* 1996 (November 1996) and compared with comparable indicators from EBRD's previous two annual reports:

- (a) price liberalization;
- (b) trade and foreign exchange reforms;
- (c) small-scale privatization;
- (d) large-scale privatization;
- (e) enterprise restructuring policy;
- (f) banking reform;
- (g) non-bank financial reforms;
- (h) competition policy; and
- (i) investment-related legal reforms.

The indicators are measured on a one-to-five scale.⁴ A "five" represents standards and performance norms typical of advanced industrial economies. In general, depending on the particular indicator, a "3" or a "4" may very well be the threshold that we seek. Descriptions of the rating categories are provided in *Appendix I*.

⁴In the 1995 and 1996 reports, the EBRD differentiates between a "4" and a "4*" to signify a division of the initial "4" category (of the 1994 report) into a lower and upper range, respectively. For simplicity, their "4*" becomes our "5".

These indicators focus on critical economic reform aspects of liberalization and institution-building in the transition process. Such reforms provide much of the overall enabling environment that is required for the emergence of a vibrant and sustainable market economy. While we review the reforms in stages below, it is important to recognize the existence of strong complementarities among them all, and the possibilities for synergism that derive from implementation of the total policy package. The other side to this is the possibility that insufficient progress in one reform aspect may undermine the potential gains from progress of another.

First Round Reforms. Following EBRD's lead, we group these indicators according to three stages in the reform process. The first round reforms consist of liberalization of prices, external trade and currency arrangements, and privatization of small-scale units.

Price liberalization focuses on the decontrolling of wages and product market prices, including key infrastructure products such as utilities and energy, and the phasing out of state procurement at non-market prices.⁵ **Trade and foreign exchange reforms** focus on the removal of trade restrictions (export tariffs, quantitative and administrative import and export restrictions, membership in the WTO), and improving access to foreign exchange (current and capital account convertibility). **Small-scale privatization** includes small firms, small farms and plots of land, and housing.

Alongside the growth of new firms, privatization is an essential aspect towards restructuring the economy into one that is private-sector driven. Price liberalization provides the appropriate incentives through market-based prices to better maximize efficiency. Trade and foreign exchange reforms provide further discipline for the private sector through global competition, as well as providing domestic firms with a greater capacity to compete.

In many respects, these first round reforms, which require relatively little institution building, have been the easiest. In fact, in CEE they have generally been adopted rapidly and quite thoroughly. By mid-1995, arguably all CEE countries but Bulgaria and Romania had advanced significantly towards achieving these reforms. Among the NIS, in contrast, perhaps only the Kyrgyz Republic and Russia have progressed sufficiently in this domain. *Table 1* below shows the status of these reforms. *Appendix I* describes the rating categories.

⁵Interest rate liberalization is monitored in EBRD's banking reform indicator.

Second Round Reforms. These reforms focus on large-scale privatization and enterprise restructuring. Measuring progress in **large-scale privatization** includes assessing the extent of the transfer to the private sector, but also the extent of outside ownership and effective corporate governance of such entities. **Enterprise restructuring reforms** address effective corporate governance in large part through government actions to tighten credit and subsidy policy at the firm level, enforce bankruptcy legislation, and break up dominant firms. Such reforms, in other words, provide the financial discipline needed for vibrant growth of the private sector.

Not surprisingly, progress towards these reforms has been slower than that of the first round reforms in no small part because they require more preparation to build political consensus as well as to create the infrastructure to implement them. In fact, as highlighted in *Table 2*, it may be that only the Czech Republic, Hungary, and Estonia have progressed sufficiently in these regards, though the Slovak Republic, Slovenia, Poland, Croatia, Lithuania, and Latvia are not far behind.

Third Round Reforms. These reforms are the most challenging, and progress is least evident in this domain. The focus here is on banking reform, private non-bank financial institutions, competition policy and investment-related legal reforms. **Banking reform** includes progress towards the establishment of bank solvency, well-functioning bank competition coupled with interest rate liberalization, financial deepening and extensiveness of private sector lending, and effective prudential supervision, with movement of laws and regulations towards BIS standards.

Non-bank financial reforms include the development and deepening of securities exchanges, investment funds, private insurance and pensions funds, leasing companies, and associated regulatory framework, with movement of laws and regulations towards IOSCO standards.

Both bank and non-bank financial reforms serve to better channel private savings to private enterprises. Such reforms facilitate investment and contribute towards enterprise restructuring.

Competition policy focuses on the development of legislation and institutions to facilitate the entry of firms, existing or potential, into existing markets. This includes the promotion of a competitive environment through enforcement actions to reduce the abuse of market power by dominant (or non-competitive) firms. The more competitive is the market structure, the greater is the efficiency of the firm.

Finally, **investment-related legal reforms** include the development of clear investment laws which do not discriminate between domestic and foreign investors, and which are well administered

and supported judicially.

As highlighted in *Table 3*, it may be that no country of ENI has yet adequately restructured in this third round set of reforms. While the Czech Republic, Hungary, and Poland have gone the farthest, it is likely that even in these three countries, more progress is needed. The Slovak Republic and Estonia are not far behind the leaders; Slovenia, Latvia, and Croatia follow in a third tier. Overall, reforms in competition policy lag the most while investment-related legal reforms show the most progress.

Economic Policy Backsliding?

In addition to ascertaining the status or level of the reforms, it is important to examine the trends over time as well. Are the economic reforms proceeding on track? *Table 4* below shows the change in economic policy reforms from 1994 to 1996. In sum, only Belarus experienced a net deterioration in economic policy reforms in the past three years. While Romania, Bulgaria, and the Kyrgyz Republic witnessed retrogression in some economic reform areas, this backsliding was more than offset by progress in other economic reforms.

In general, progress in economic reforms over the past two years has been most evident among those countries at an intermediate stage in the transition process. This includes Albania and Macedonia in CEE, and Georgia, Armenia, Ukraine, Kazakstan, Moldova, and Russia in the NIS. Countries at a more advanced transition stage--including Hungary, Poland, the Czech Republic, Slovenia, the Slovak Republic, and Lithuania--tended to make less progress in large part because the remaining reforms are the most difficult and take the most time to implement and enforce.

Table 1. First Round Economic Policy Reforms¹

	Small-scale Privatization	Price Liberalization	Trade & Foreign Exchange	Average
Czech Rep.	5	3	5	4.3
Hungary	5	3	5	4.3
Slovak Rep.	5	3	5	4.3
Slovenia	5	3	5	4.3
Poland	5	3	5	4.3
Estonia	5	3	4	4.0
Croatia	5	3	4	4.0
Albania	4	3	4	3.7
Latvia	4	3	4	3.7
Lithuania	4	3	4	3.7
Macedonia	4	3	4	3.7
Kyrgyz Rep.	4	3	4	3.7
Russia	4	3	4	3.7
Armenia	3	3	4	3.3
Moldova	3	3	4	3.3
Georgia	4	3	3	3.3
Kazakhstan	3	3	4	3.3
Romania	3	3	3	3.0
Bulgaria	3	2	4	3.0
Ukraine	3	3	3	3.0
Uzbekistan	3	3	2	2.7
Azerbaijan	2	3	2	2.3
Belarus	2	3	2	2.3
Tajikistan	2	3	2	2.3
Turkmenistan	1	2	1	1.3
Averages:				
CEE & NIS	3.7	3.0	3.7	3.5
CEE	4.4	2.9	4.4	3.9
NIS	3.4	3.0	3.4	3.3
Industrial Countries	5	5	5	5
Benchmarks	4	3	4	3.7

¹EBRD, *Transition Report 1996* (November 1996). Descriptions of the rating categories are provided in *Appendix I*. On a 1-5 scale with 5 being the most advanced. All CEE & NIS averages in this report are population-weighted.

Table 2. Second Round Economic Policy Reforms¹

	Large-scale Privatization	Enterprise Restructuring	Average
Czech Rep.	4	3	3.5
Hungary	4	3	3.5
Estonia	4	3	3.5
Slovak Rep.	3	3	3.0
Slovenia	3	3	3.0
Poland	3	3	3.0
Croatia	3	3	3.0
Lithuania	3	3	3.0
Latvia	3	3	3.0
Macedonia	3	2	2.5
Romania	3	2	2.5
Armenia	3	2	2.5
Georgia	3	2	2.5
Kazakhstan	3	2	2.5
Kyrgyz Rep.	3	2	2.5
Moldova	3	2	2.5
Russia	3	2	2.5
Uzbekistan	3	2	2.5
Albania	2	2	2.0
Bulgaria	2	2	2.0
Ukraine	2	2	2.0
Tajikistan	2	1	1.5
Azerbaijan	1	2	1.5
Belarus	1	2	1.5
Turkmenistan	1	1	1.0
Averages:			
CEE & NIS	2.8	2.2	2.5
CEE	3.1	2.7	2.9
NIS	2.6	2.0	2.3
Industrial Countries	5	5	5
Benchmarks	4	3	3.5

¹EBRD, *Transition Report 1996* (November 1996). Descriptions of the rating categories are provided in *Appendix I*.

Table 3. Third Round Economic Policy Reforms¹

	Competition Policy	Bank Reforms	Non-Bank Financial Reforms	Legal Reforms	Average
Czech Rep.	3	3	3	4 (4 5)	3.3
Hungary	3	3	3	4 (5 4)	3.3
Poland	3	3	3	4 (3 4)	3.3
Slovak Rep.	3	3	3	3 (3 4)	3.0
Estonia	3	3	2	4 (4 5)	3.0
Slovenia	2	3	3	3 (2 5)	2.8
Latvia	2	3	2	4 (5 3)	2.8
Croatia	2	3	2	4 (4 5)	2.8
Bulgaria	2	2	2	4 (4 4)	2.5
Russia	2	2	3	3 (5 2)	2.5
Lithuania	2	3	2	2 (2 2)	2.3
Romania	1	3	2	3 (4 3)	2.3
Albania	2	2	2	3 (5 1)	2.3
Moldova	2	2	2	3 (3 3)	2.3
Ukraine	2	2	2	3 (2 4)	2.3
Uzbekistan	2	2	2	3 (5 2)	2.3
Macedonia	1	3	1	3 (5 2)	2.0
Kazakhstan	2	2	2	2 (2 2)	2.0
Kyrgyz Rep.	2	2	2	2 (3 2)	2.0
Armenia	1	2	1	3 (4 3)	1.8
Georgia	2	2	1	2 (2 2)	1.8
Azerbaijan	1	2	1	2 (2 2)	1.5
Belarus	2	1	2	1 (2 1)	1.5
Tajikistan	1	1	1	2 (2 2)	1.3
Turkmenistan	1	1	1	1 (1 1)	1.0
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Averages:					
CEE & NIS	2.1	2.2	2.5	3.0	2.5
CEE	2.4	2.9	2.6	3.6	2.9
NIS	1.9	1.9	2.4	2.8	2.3
Industrial Countries	5	5	5	5	5
Benchmarks	4	3	4	4	3.8

¹EBRD, *Transition Report 1996* (November 1996). Descriptions of the rating categories are provided in *Appendix I*. The rating of legal reforms to foster investment is subdivided (in parentheses) into extensiveness and effectiveness respectively.

Table 4. Change in economic policy reforms: 1994-1996¹

	1st Round			2nd Round		3rd Round				
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	Ave.
Georgia	2	0	2	2	1	1	1	0	0	1.0
Armenia	0	0	2	2	1	0	1	0	1	0.8
Ukraine	1	0	2	1	1	0	1	0	1	0.8
Kazakhstan	1	0	2	1	1	0	1	0	0	0.7
Albania	1	0	0	1	0	1	0	1	1	0.6
Azerbaijan	1	0	1	0	1	0	1	0	1	0.6
Latvia	1	0	0	1	1	0	0	0	2	0.6
Moldova	1	0	2	1	0	0	0	0	1	0.6
Croatia	1	0	0	0	1	1	0	0	1	0.4
Russia	1	0	1	0	0	0	0	1	1	0.4
Uzbekistan	0	0	0	1	1	0	1	0	1	0.4
Estonia	1	0	0	1	0	0	0	0	1	0.3
Macedonia	0	0	0	1	0	0	1	0	1	0.3
Hungary	1	0	1	1	0	0	0	0	0	0.3
Slovenia	1	0	1	1	0	0	0	0	0	0.3
Czech Rep.	1	0	1	0	0	0	0	0	0	0.2
Lithuania	0	0	0	0	1	0	1	0	0	0.2
Poland	1	0	1	0	0	0	0	0	0	0.2
Romania	0	0	-1	1	0	0	1	0	1	0.2
Slovak Rep.	1	0	1	0	0	0	0	0	0	0.2
Tajikistan	0	0	1	0	0	0	0	0	1	0.2
Bulgaria	1	-1	0	0	0	0	0	0	1	0.1
Kyrgyz Rep.	0	0	1	0*	0	0	0	0	0	0.1
Turkmenistan	0	0	0	0	0	0	0	0	0	0.0
Belarus	0	0	1	-1	0	0	0*	0	-1	-0.1
CEE & NIS	0.7	0.0	0.8	0.6	0.4	0.1	0.4	0.1	0.6	0.4
CEE	0.8	-0.1	0.4	0.5	0.2	0.2	0.2	0.1	0.6	0.2
NIS	0.6	0.0	1.3	0.6	0.5	0.1	0.5	0.1	0.5	0.5
Benchmark										0.0

¹EBRD, *Transition Report* (1994, 1995 & 1996). (1) small-scale privatization; (2) price liberalization; (3) trade & foreign exchange reforms; (4) large-scale privatization; (5) enterprise restructuring; (6) competition policy; (7) bank reforms; (8) non-bank financial reforms; (9) legal reforms. The change is based on a rating from 1-to-5; e.g., a "1" represents policy advancement from the previous time period a full increment on this 1-to-5 scale. The figures show a change from 1994-1996 for most of the indicators. For price liberalization, competition policy, non-bank financial reforms, and legal reforms indicators, it is a one year (1995-96) change. An "*" represents an advancement in 1995 which was offset by a deterioration in 1996.

B. Democratization

Progress towards democracy building is assessed from indicators drawn from Freedom House. Both the status and the change since 1991 in political rights and civil liberties are examined. As with the economic reforms, sufficient progress must entail both an adequate threshold as well as no significant deterioration.

Political Rights. Six primary criteria go into the determination of political freedoms:

- (a) the extent to which elections for head of government are free and fair;
- (b) the extent to which elections for legislative representatives are free and fair;
- (c) the ability of voters to endow their freely elected representatives with real power;
- (d) the openness of the system to competing political parties;
- (e) the freedom of citizens from domination by the military, foreign powers, totalitarian parties, and other powerful groups; and
- (f) the extent to which minority groups have reasonable self-determination and self-government.

An elaboration of Freedom House's rating scheme of political rights and civil liberties is provided in *Appendix I*.

Greater political liberties are both part of the end objective of a sustainable transition as well as a means to facilitate the economic reforms needed to achieve the transition. Arguably, the most credible route must be one which is facilitated by an open and competitive political system at all levels of government. This system must be sustained by broad-based participation from the electorate, and this electorate must have genuine influence on the course of political events. Such a route may not be the most rapid means of change, but it is by definition the most agreeable means among the citizens and hence likely the most sustainable.

Table 5 below highlights the results. There are five countries in CEE (the Czech Republic, Hungary, Lithuania, Slovenia, and Poland) where political freedoms are among the most advanced in the world; that is, comparable to those found in the industrial market economies. The Czech Republic, Hungary, Lithuania, and Slovenia have maintained this level of freedom since at least 1992 or 1993. Poland achieved this level in 1995. In scoring

the second highest level, four other countries (Bulgaria, the Slovak Republic, Estonia, and Latvia) are not far behind.

One CEE country (Macedonia) and seven NIS (Kyrgyz Republic, Belarus, Kazakhstan, Azerbaijan, Uzbekistan, Tajikistan, and Turkmenistan) had fewer political rights in 1995 than in 1991 or 1992. Other countries (Estonia, Ukraine, Armenia, and Georgia) have experienced temporary backsliding in the development of political rights. Political rights in Turkmenistan, Tajikistan, and Uzbekistan in 1995 were as few as anywhere in the world.

Table 5. Political Rights¹

	<u>1991</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1991-95 Change</u>
Czech Rep.	--	--	1	1	1	0
Hungary	2	2	1	1	1	+1
Lithuania	2	2	1	1	1	+1
Slovenia	--	1	1	1	1	0
Poland	2	2	2	2	1	+1
Bulgaria	2	2	2	2	2	0
Slovak Rep.	--	--	3	2	2	+1
Estonia	2	3	3	3	2	0
Latvia	2	3	3	3	2	0
Albania	4	4	2	3	3	+1
Russia	3	3	3	3	3	0
Ukraine	3	3	4	3	3	0
Romania	5	4	4	4	4	+1
Croatia	--	4	4	4	4	0
Moldova	5	5	5	4	4	+1
Armenia	5	4	3	3	4	+1
Georgia	6	4	5	5	4	+2
Macedonia	--	3	3	4	4	-1
Kyrgyz Rep.	3	4	5	4	4	-1
Belarus	4	4	5	4	5	-1
Kazakstan	5	5	6	6	6	-1
Azerbaijan	5	5	6	6	6	-1
Uzbekistan	6	6	7	7	7	-1
Tajikistan	5	6	7	7	7	-2
Turkmenistan	6	7	7	7	7	-1
CEE & NIS ave.	3.2	3.4	3.6	3.4	3.3	+0.1
CEE ave.	2.8	2.6	2.3	2.3	2.0	+0.7
NIS ave.	3.6	3.6	4.1	3.8	3.8	-0.2
EU ² ave.					1	
OECD ³ ave.					1.3	
Benchmarks					1	0

¹Freedom House, *Freedom in the World* (1996), and *Nations in Transit*, commissioned by USAID/ENI/DG (July 1995). The rating ranges from 1 to 7; the lower is the number, the greater is the freedom. *Appendix I* elaborates. A "+" refers to an increase in freedom; a "-" to a decrease. The change in the Czech and Slovak Republics is calculated from 1993-1995; for Slovenia, Macedonia, and Croatia, from 1992-1995.

²All 15 member states score "1".

³Two of the 29 member countries are awaiting ratification (Korea and Poland). Poland, the Czech Rep., and Hungary are the only members from CEE. All but three members score a "1"; the exceptions are Turkey ("5"), Mexico ("4"), and Korea ("2").

Civil Liberties. Ten primary criteria go into the determination of civil liberties:

- (a) freedom of media, literature, and other cultural expressions;
- (b) existence of open public discussion and free private discussion including religious expressions;
- (c) freedom of assembly and demonstration;
- (d) freedom of political or quasi-political organization (which includes political parties, civic associations, and ad hoc issue groups);
- (e) equality of citizens under law with access to independent, nondiscriminatory judiciary;
- (f) protection from political terror and freedom from war or insurgency situations;
- (g) existence of free trade unions, professional organizations, businesses or cooperatives, and religious institutions;
- (h) existence of personal social freedoms, which include gender equality, property rights, freedom of movement, choice of residence, and choice of marriage and size of family;
- (i) equality of opportunity; and
- (j) freedom from extreme government indifference and corruption.

Civil liberties are the freedoms to develop views, institutions, and personal autonomy apart from the state. The development of civil liberties, like political liberties, is an end objective in itself. The merits of such liberties as freedom of assembly and open public discussions, and freedom from political terror and war are self-evident.

However, greater civil liberties can also serve as a crucial counterweight or check on governments in societies where political rights are lacking. This counterweight can be found among NGOs (such as free trade unions, professional organizations, and religious institutions) as well as a free media. An independent, nondiscriminatory judiciary is critical for similar reasons.

In addition, civil liberties tend to link quite closely with economic progress. Many--such as greater equality of opportunity, freedom from corruption, the existence of personal social freedoms such as gender equality, property rights, freedom of movement--contribute to a more productive economy as well as a

more just one.

Table 6 below highlights the results. Eight countries of CEE (the Czech Republic, Poland, Slovenia, Hungary, Bulgaria, Estonia, Latvia, and Lithuania) have civil liberties comparable to several industrial market economies, including France, Germany, Italy, and the UK. Five of these countries (the Czech Republic, Poland, Slovenia, Hungary, and Bulgaria) have maintained this threshold since at least 1992. Of these eight, only Latvia showed a relapse, albeit temporary, in civil liberties during this period.

In striking contrast, all but one country of the NIS (Georgia) regressed at least temporarily in the development of civil liberties from 1991 to 1995. Eight of these countries experienced a net decline in civil liberties during this period. As with political rights, Uzbekistan, Turkmenistan, and Tajikistan are rated by Freedom House as having civil liberties in 1995 as few as any country in the world.

Table 6. Civil Liberties¹

	<u>1991</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1991-95 Change</u>
Czech Rep.	--	--	2	2	2	0
Poland	2	2	2	2	2	0
Slovenia	--	2	2	2	2	0
Hungary	2	2	2	2	2	0
Bulgaria	3	3	2	2	2	+1
Estonia	3	3	2	2	2	+1
Latvia	2	3	3	2	2	0
Lithuania	3	3	3	3	2	+1
Macedonia	--	3	3	3	3	0
Slovak Rep.	--	--	4	3	3	+1
Romania	5	4	4	3	3	+2
Albania	4	3	4	4	4	0
Croatia	--	4	4	4	4	0
Armenia	5	3	4	4	4	+1
Kyrgyz Rep.	4	2	3	3	4	0
Moldova	4	5	5	4	4	0
Russia	3	4	4	4	4	-1
Ukraine	3	3	4	4	4	-1
Georgia	5	5	5	5	5	0
Belarus	4	3	4	4	5	-1
Kazakhstan	4	5	4	5	5	-1
Azerbaijan	5	5	6	6	6	-1
Tajikistan	5	7	7	7	7	-2
Turkmenistan	5	6	7	7	7	-2
Uzbekistan	5	6	7	7	7	-2
CEE & NIS ave.	3.1	3.7	3.9	3.9	3.9	-0.6
CEE ave.	3.0	2.8	2.7	2.4	2.4	+0.6
NIS ave.	3.5	4.1	4.4	4.5	4.5	-1.0
EU ² ave.					1.5	
OECD ³ ave.					1.7	
Benchmarks					2	0

¹Freedom House, *Freedom in the World* (1996), and *Nations in Transit*, commissioned by USAID/ENI/DG (July 1995). The rating ranges from 1 to 7; the lower is the number, the greater is the freedom. Appendix I elaborates. A "+" refers to an increase in freedom; a "-" to a decrease. The change in the Czech and Slovak Republics is calculated from 1993-1995; for Slovenia, Macedonia, and Croatia, from 1992-1995.

²Nine of the 15 members score a "1"; 5 score a "2" (France, Germany, Italy, Spain, and UK); and Greece scores a "3".

³Sixteen member states score a "1"; 10 score a "2" (Korea, Poland, UK, Czech Rep., France, Hungary, Italy, Germany, Japan, and Spain); Greece scores a "3", Mexico a "4", and Turkey a "5".

C. Summary of Economic Reforms & Democratization

Table 7 provides a summary picture of the current status of the economic policy reforms and democratic freedoms. The economic policy reform ratings represent an average of all nine EBRD policy indicators (that is, all three rounds). The democratic freedom ratings incorporate Freedom House's rating of political rights and civil liberties. For uniformity, Freedom House's ratings were compressed to a one-to-five scale with five representing the most free. Figure 1 portrays these data to help ascertain how and to what extent economic policy and democratic reforms might be linked.

Salient observations. In general, progress in economic reforms and democratization in CEE is much greater than in the NIS. The gap is greatest in democratization. Nine of the thirteen countries of CEE exhibit greater democratic freedoms than any of the NIS. Of the countries of CEE, only Croatia lags behind some NIS (in particular, Russia and Ukraine) in this domain.

Economic reforms are further along in eight CEE countries relative to those in any of the NIS. Economic reforms in Bulgaria and Romania are the least advanced among CEE. Russia's economic reforms are the most advanced among the NIS, comparable, in fact, to those in Lithuania.

There is a close correspondence between the development of economic reforms and democratization. Progress in both areas is the most advanced in the Czech Republic, Hungary, and Poland. Turkmenistan, Tajikistan, Azerbaijan, Belarus, and Uzbekistan, rank towards the bottom in both areas.

However, there seems to be a handful of countries, mostly in CEE, where progress is significantly further along on the democracy front than in economic reforms. This includes Bulgaria, Lithuania, Slovenia, and, among the NIS, Ukraine. Lithuania and Slovenia rank among the highest in democratization, but rank ninth and sixth, respectively, in economic policy reforms.

Croatia is distinguished by advancing relatively far in economic reforms (ranking seventh) despite relatively few democratic freedoms (ranking fifteenth). This holds true to a lesser extent for the Slovak Republic and Kazakhstan.

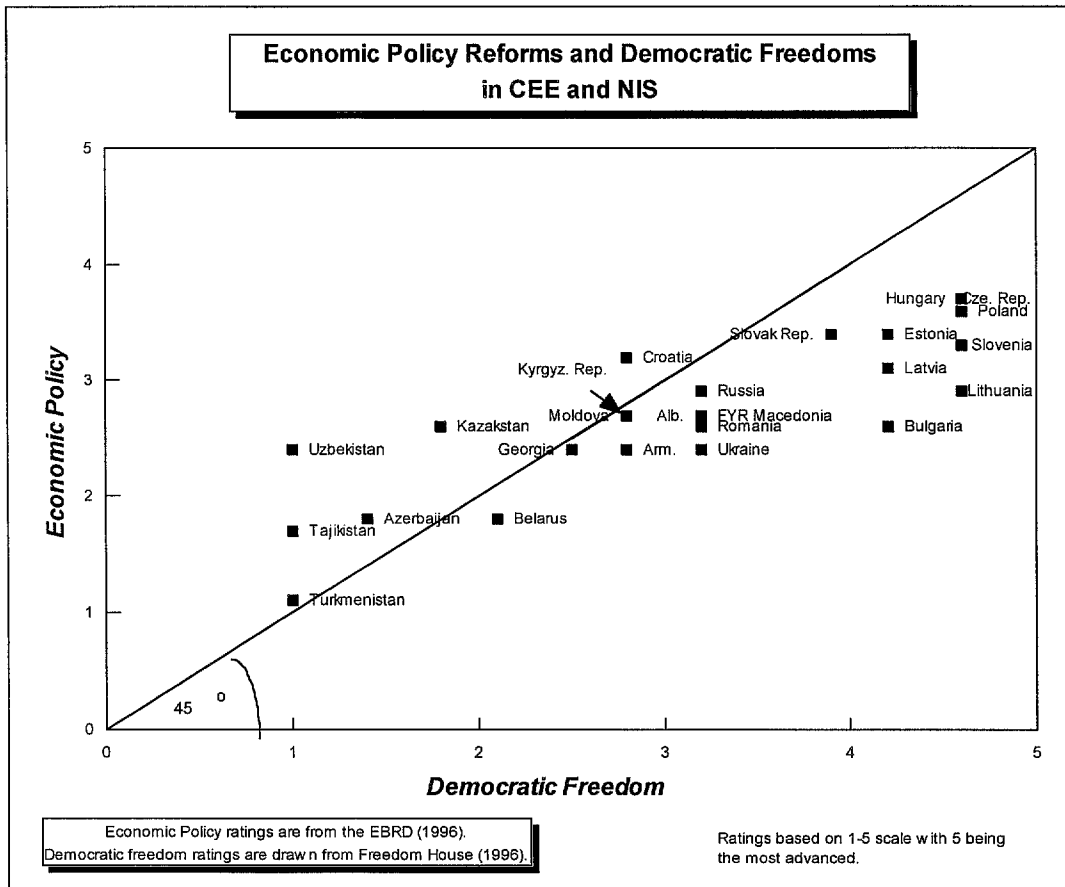
Relative to standards in the industrial market economies, economic policy reforms in ENI still have far to go. While this holds true for democratic reforms in many transition economies as well, five CEE countries have attained a level of democratic freedom comparable to that which exists in many OECD countries.

Table 7. Economic Policy Reforms and Democratic Freedoms in CEE & NIS¹

	Economic Policy		Democratic Freedoms		
	Rating	Ranking	Rating	Ranking	
Czech Rep.	3.7	1	Czech Rep.	4.6	1
Hungary	3.7	1	Hungary	4.6	1
Poland	3.6	3	Poland	4.6	1
Estonia	3.4	4	Slovenia	4.6	1
Slovak Rep.	3.4	4	Lithuania	4.6	1
Slovenia	3.3	6	Estonia	4.2	6
Croatia	3.2	7	Latvia	4.2	6
Latvia	3.1	8	Bulgaria	4.2	6
Lithuania	2.9	9	Slovak Rep.	3.9	9
Russia	2.9	9	Romania	3.2	10
Albania	2.7	11	Albania	3.2	10
Macedonia	2.7	11	Macedonia	3.2	10
Moldova	2.7	11	Russia	3.2	10
Kyrgyz Rep.	2.7	11	Ukraine	3.2	10
Bulgaria	2.6	15	Croatia	2.8	15
Romania	2.6	15	Moldova	2.8	15
Kazakstan	2.6	15	Armenia	2.8	15
Armenia	2.4	18	Kyrgyz Rep.	2.8	15
Georgia	2.4	18	Georgia	2.5	19
Ukraine	2.4	18	Belarus	2.1	20
Uzbekistan	2.4	18	Kazakstan	1.8	21
Belarus	1.8	22	Azerbaijan	1.4	22
Azerbaijan	1.8	22	Uzbekistan	1.0	23
Tajikistan	1.7	24	Tajikistan	1.0	23
Turkmenistan	1.1	25	Turkmenistan	1.0	23
CEE & NIS ave.	2.8			3.1	
CEE ave.	3.2			4.1	
NIS ave.	2.6			2.7	
EU ave.	5.0			4.8	
OECD ave.	--			4.6	

¹Economic Policy ratings are from EBRD, *Transition Report 1996* (November 1996); democracy ratings are drawn from Freedom House, *Freedom in the World, 1995-1996* (March 1996). On a 1-5 scale with 5 being the most advanced. Elaboration of rating schemes is provided in *Appendix I*.

Figure 1



D. Sustainability

In this section, we weigh the economic and political reforms with the macroeconomic and microeconomic evidence. Economic policy reforms need to translate into good macroeconomic performance. Yet, this is not enough. The benefits at the macro level must also be reasonably well distributed and need to translate into social conditions that at the least are not significantly deteriorating. Otherwise, the reforms may stall for lack of support, and/or fiscal sustainability may be jeopardized.

It merits stating that the quality of these data are often questionable. Credible comparisons across time and across countries are sometimes difficult. In general, data for CEE are better than that for the NIS, and much of the economic data are likely better than much of the social data. Conclusions should be based on a variety of evidence if possible.

1. Macroeconomic Performance.

Tables 8 through 13 highlight macroeconomic performance. Fundamental to sustaining reforms is sustained economic growth at some moderate rate. As evident in Table 8, most of the CEE countries are achieving this. The CEE region as a whole in fact has been growing at a very impressive clip; more than four percent over the past three years and almost double the EU rate. Some CEE countries--Poland, Albania, Slovenia, and Romania--have been experiencing sustained positive growth for more than three consecutive years.

However, three CEE countries (Macedonia, Latvia, and Bulgaria) have failed to sustain any significant economic growth in recent years. Bulgaria's economy will likely contract by four percent in 1996.

In striking contrast to the overall robust growth in CEE, the economies of the NIS are still contracting, though the pace of this decline is slowing. Armenia is the only NIS which has experienced a positive three-year economic growth rate. Further, the Kyrgyz Republic, Moldova, and Georgia may likely be the only other NIS countries to register significant positive economic growth in 1996.

For most countries of the region, inflation continues to fall (Table 9). The drop in inflation is particularly impressive in the NIS where 1996 inflation may be close to forty percent, down from 172 percent in 1995 and comparable to 1996 CEE inflation.

Still, inflation is too high in most countries. Annual inflation rates much above the single-digit range erodes business

confidence, and the ability and incentive to invest and expand at the enterprise level. Only five countries, all in CEE (Croatia, the Slovak Republic, the Czech Republic, Slovenia, and Albania), will likely have a three-year inflation rate below fifteen percent. By comparison, EU inflation in recent years has remained below three percent. Of these five CEE countries, Albania is currently witnessing a significant resurgence in inflation. This seems also to be the case for Romania and Bulgaria.

Budget deficits (*Table 10*) which remain high fuel inflation and unproductive activity, particularly if financial markets are not well-functioning. If in fact the financial markets are well-established, high budget deficits may ultimately crowd out potential private sector investors from such markets.

The trends in fiscal balances vary widely. While the overall deficit in ENI has declined substantially from 1993 and 1994, almost one-half of the countries nevertheless will likely experience some deterioration in the fiscal balance during 1996. Still, there may be as many as ten countries with 1994-1996 fiscal balances which better the EU target of a three percent deficit. Most of the countries are in CEE. In fact, despite high deficits in Albania, Bulgaria, Hungary, and probably Romania, the CEE average comes under the three percent deficit target.

Table 11 shows trends in domestic investment and the share of the economies in private sector hands. One might expect to find a direct relation between the two: those economies which are predominantly private sector driven are more likely to have higher investment rates. This relationship is not evident in the data, however, and this may reflect the bluntness and/or credibility of the figures. Both indicators are very difficult to gauge, and this should be factored into any review.

Still, other factors being equal, those economies which predominantly produce private sector output are much more likely to generate a momentum towards greater private sector growth and development. In fact, fifteen countries of the region now do have a private sector generating at least fifty percent of GDP.

In CEE, only Slovenia and Bulgaria do not yet meet this threshold. Slovenia is a particularly interesting case since its economy is a relatively strong performer.

In the NIS, the economies which have made the greatest structural change by this standard are Russia, Armenia, Georgia, and the Kyrgyz Republic. All have at least fifty percent of the economy generated by the private sector.

Domestic investment (*Table 11*), as with foreign direct

investment, contributes to the productive capacity of the economy and helps provide the momentum which is necessary for sustained economic expansion further down the road. Domestic investment in the region on average is roughly twenty-two percent of GDP. This is above the EU and OECD averages, though falls far short of that generated in the high performing Asian developing economies.

The regional average masks wide variation. If the figures are credible, some economies are investing very little. This may include Georgia, Moldova, Ukraine, Macedonia, Croatia, and Latvia.

Paralleling GDP trends, the large majority of economies have experienced a significant decline in investment since 1990. However, this trend may be changing. The 1994-1995 data seem to indicate a resumption of investment growth for many of the countries. This needs to be closely monitored.

An important indicator of the extent to which firms are restructuring is the productivity of labor, or output per employee (*Table 12*). The efficiency gains from an increase in productivity would likely stem from a number of possibilities, including fewer excess workers, greater skilled and/or motivated workers, improved capital stock, and/or a greater capacity to manage.

Labor productivity in industry is increasing in the CEE countries for which data are available. The productivity increase has been most impressive in Hungary and Poland, increasing since 1992 at an average annual rate of close to fifteen percent. At least four CEE countries (Hungary, Poland, Bulgaria, and Slovenia) now have regained levels of productivity prior to the transition. The Czech Republic is not far behind. In the NIS, productivity continues to decline in Ukraine. Russia witnessed an increase of 5% in 1995, though it is not yet clear if this is part of a general trend.

How and to what extent these economies integrate into the world economy play significantly into the type of the transition path and its sustainability. *Table 13* highlights some key aspects of this integration: export growth; current account balances; foreign direct investment; debt service as a percent of exports; and institutional integration.

The gains from trade can be substantial, and range from the tangible (of increasing an economy's quantity and quality of available goods, including capital goods) to the intangible (of providing incentives and a constituency to maintain the market-based reforms which also serve as pre-requisites to institutional integration with the industrial market economies).

Export growth in CEE is very high. To contrast, CEE exports grew

by seventeen percent in 1994-1995; for the EU, 1994 export growth was four percent. Export growth in Albania, Estonia, and Romania has been particularly robust; export growth in Slovenia, Bulgaria, and Macedonia has been lagging.⁶

While a handful of NIS are experiencing rapid export growth (Moldova, Belarus, and Uzbekistan), five countries experienced a contraction in exports from 1994-1995. The overall average is just shy of EU export growth. More trade data, including the direction and composition of exports, may be needed to add to the picture.

Most ENI countries are incurring current account deficits (Table 13). To some extent, as the economies climb out of the "transition trough", current account deficits can be expected, and may even be a reflection of positive developments. Some of the transition leaders in CEE in fact registered sharp deteriorations in current account deficits in 1995 and early 1996 due largely to robust economic growth (and presumably not because of any significant decline in export competitiveness).

Nevertheless, such deficits cannot be sustained over the longer-term without adverse consequences. The current account data in Table 13 aggregate two years only (1994-95), and this needs to be extended to three at a minimum. With that limitation in mind, these data indicate that several CEE countries--Albania in particular; Hungary, Estonia and Macedonia as well--may be incurring unsustainably high current account deficits. Among the NIS, this seems to be the case for Armenia, Georgia, Kyrgyz Republic, and Azerbaijan in particular.

Capital flows from abroad can help finance these deficits, and presumably mitigate adverse macroeconomic consequences, provided the investment flows are relatively stable. In fact, foreign direct investment (FDI) as a percent of GDP is among the highest in three of the four CEE countries in which the current account deficit is also among the highest; that is, Hungary, Albania, and Estonia. Hungary attracts far and away the greatest amount of FDI as percent of GDP in the region. It also has far and away the highest debt service burden, and this needs to be monitored.

An important means to institutionalizing global integration, and

⁶While the EBRD data show relatively slow export export growth for Latvia in 1994-1995, a recent study prepared for USAID finds very high export growth, while also asserting that trade figures are reported to be amongst the most inaccurate of Latvia's reported statistics. See: Steven Tabor & George Laudato, *Priorities for Future U.S. Agency for International Development Assistance to Latvia: Critical Gaps in Transition*, December 1996 draft.

hence to locking-in the gains from reform, is through memberships and/or participation in international organizations. For our purposes, this includes membership in the OECD, the World Trade Organization, possibly NATO, and participation in the "Europe Agreements" with the EU (as a precursor to EU membership). As shown in *Table 13*, institutional integration, as so defined, is taking place only among the CEE countries.⁷ Even within CEE, however, the extent of institutional integration varies widely. The Czech Republic, Hungary, and Poland are the most engaged; Albania, Croatia, and Macedonia so far not at all.

⁷Some of these measures are more applicable to CEE than to the NIS. Energy infrastructure links with Western Europe might also be included in future reports.

Table 8. Growth in Real GDP (percent change)¹

	1992	1993	1994	1995	1996	'94-96 ave.
Albania	-9.7	11.0	9.4	8.6	5.0	7.7
Armenia	-52.4	-14.8	5.4	6.9	6.5	6.3
Slovak R.	-6.5	-4.1	4.8	7.4	5.5	5.9
Poland	2.6	3.8	5.2	7.0	5.0	5.7
Romania	-8.8	1.3	3.9	6.9	4.5	5.1
Czech Rep.	-6.4	-0.9	2.6	4.8	5.1	4.2
Slovenia	-5.4	1.3	5.3	3.5	3.0	3.9
Croatia	-10.0	-3.7	0.8	2.0	5.0	2.6
Estonia	-14.2	-8.5	-0.1	3.2	3.0	2.0
Hungary	-3.1	-0.6	2.9	1.5	1.5	2.0
Lithuania	-37.7	-24.2	1.0	3.1	1.5	1.9
Bulgaria	-7.3	-2.4	1.8	2.6	-4.0	0.1
Latvia	-35.0	-16.0	0.6	-1.6	1.0	0.0
Macedonia	-21.1	-8.4	-4.0	-1.5	3.0	-0.8
Uzbekistan	-11.1	-2.3	-4.2	-1.2	-1.0	-2.1
Russia	-14.5	-8.7	-12.6	-4.0	-3.0	-6.5
Kyrgyz R.	-19.0	-16.0	-26.5	1.3	2.0	-7.7
Georgia	-40.3	-39.0	-35.0	2.4	8.0	-8.2
Belarus	-9.6	-10.6	-12.2	-10.2	-5.0	-9.1
Moldova	-29.0	-1.0	-31.0	-3.0	4.0	-10.0
Turkmenistan	-5.3	-10.0	-20.0	-10.0	0.0	-10.0
Azerbaijan	-22.6	-23.1	-21.2	-8.3	-3.5	-11.0
Kazakstan	-13.0	-12.0	-25.0	-8.9	0.5	-11.1
Tajikistan	-29.0	-11.1	-21.5	-12.5	-7.0	-13.7
Ukraine	-10.0	-14.0	-23.0	-11.8	-7.0	-13.9
<hr/>						
Averages:						
CEE & NIS	-12.2	-7.5	-10.1	-2.5	-1.1	-4.6
CEE	-5.8	-0.1	3.7	5.3	3.7	4.2
NIS	-14.8	-10.5	-15.7	-5.7	-3.0	-8.1
<hr/>						
Industrial Countries			2.8	2.1	2.3	2.4
EU			2.8	2.5	1.6	2.3
Developing Countries			6.6	5.9	6.3	6.3

Benchmarks

(a) 3 yrs. positive growth;

(b) 3 yr. ave. growth of 2.0% or more

¹EBRD, *Transition Report 1996* (November 1996), World Bank, *World Development Report 1996* (June 1996), and IMF, *World Economic Outlook* (October 1996).

Table 9. Inflation¹

	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>	'95-96 <u>ave.</u>	'94-96 <u>ave.</u>
Croatia	937.0	1,150	-3.0	4.0	5.0	4.5	2.0
Slovak R.	9.0	25.0	12.0	7.0	6.0	6.5	8.3
Czech Rep.	13.0	18.0	10.0	8.0	9.0	8.6	9.0
Slovenia	93.0	23.0	18.0	9.0	10.0	9.5	10.7
Albania	237.0	31.0	16.0	6.0	20.0	13.0	14.0
Macedonia	1,935	230.0	55.0	9.0	2.0	5.5	22.0
Latvia	958.0	35.0	26.0	23.0	19.0	21.0	22.7
Poland	44.0	38.0	29.0	22.0	19.0	20.5	23.3
Hungary	22.0	21.0	21.0	28.0	22.0	25.0	23.7
Estonia	954.0	36.0	42.0	29.0	24.0	26.5	31.7
Lithuania	1,020	390.2	72.0	39.5	28.0	33.8	46.5
Kyrgyz Rep.	1,771	1,366	87.0	32.0	27.0	29.5	48.7
Romania	199.0	296.0	62.0	28.0	60.0	44.0	50.0
Moldova	2,198	837	116.0	24.0	18.0	21.0	52.7
Bulgaria	79.0	64.0	122.0	33.0	165.0	99.0	106.7
Russia	2,318	841	203.0	131.0	25.0	78.0	119.7
Ukraine	2,000	10,155	401	182	55.0	118.5	212.7
Kazakhstan	2,567	2,169	1,160	60.0	26.0	43.0	415.3
Uzbekistan	910	885	1,281	117	35.0	76.0	477.7
Tajikistan	1,364	7,344	5.0	1,500	200	850.0	568.3
Azerbaijan	1,395	1,294	1,788	86.0	15.0	50.5	629.7
Armenia	1,341	10,996	1,885	32.0	19.0	25.5	645.3
Belarus	1,558	1,994	1,957	244.0	61.0	152.5	754.0
Turkmenistan	644	9,750	1,330	1,000	250	625.0	860.0
Georgia	1,176	7,488	7,144	65.0	23.0	44.0	2,410
<hr/>							
Averages:							
CEE & NIS	1,500	2,308	473	129	38.0	83.5	213.3
CEE	203	147	39.1	21.7	36.0	28.9	32.3
NIS	2,023	3,180	648	172	38.8	105.4	286.3
Industrial							
Countries			2.3	2.4	2.3	2.4	2.3
EU			2.9	2.9	2.6	2.8	2.8
Developing							
Countries			46.8	19.8	13.3	16.6	26.6
Benchmarks						<10.0	15.0

¹EBRD, *Transition Report 1996* (November 1996), World Bank, *World Development Report 1996* (June 1996), and IMF, *World Economic Outlook* (October 1996). Retail/consumer prices (end-year).

Table 10. Fiscal Balance as Percent of GDP¹

	1993	1994	1995	1996 (est)	'94-96 ave.
Czech Rep.	0.8	0.9	0.4	0.0	0.4
Slovak Rep.	-7.1	-1.1	3.2	-1.5	0.2
Slovenia	0.3	-0.2	0.0	-0.4	-0.2
Croatia	-1.0	1.7	-0.9	-3.0	-0.7
Estonia	-0.7	1.3	-0.8	-1.5	-1.0
Turkmenistan	-0.5	-1.4	-1.6	--	-1.5
Macedonia	-14.0	-3.0	-1.0	-1.0	-1.7
Romania	-0.1	-1.0	-2.8	-2.0	-1.9
Belarus	-8.3	-2.6	-1.9	-2.0	-2.2
Poland	-2.9	-2.0	-3.5	-2.7	-2.7
Latvia	0.6	-4.0	-3.3	-2.0	-3.1
Lithuania	-3.1	-4.2	-3.3	-3.4	-3.6
Kazakstan	-1.2	-6.8	-2.3	-4.0	-4.4
Uzbekistan	-10.5	-6.1	-4.1	-3.5	-4.6
Georgia	-26.0	-7.4	-4.8	-4.0	-5.4
Bulgaria	-10.9	-5.8	-5.7	-5.0	-5.5
Hungary	-6.8	-8.2	-6.5	-4.0	-6.2
Moldova	-6.8	-9.0	-5.5	-4.0	-6.2
Ukraine	-9.7	-8.2	-5.0	-6.5	-6.6
Russia	-7.6	-10.1	-4.9	-6.0	-7.0
Azerbaijan	-13.0	-14.8	-7.0	-3.0	-8.3
Kyrgyz Rep.	-13.5	-7.7	-12.5	-5.5	-8.6
Tajikistan	-25.0	-10.5	-11.2	-6.0	-9.2
Armenia	-48.2	-16.5	-9.9	-6.8	-11.1
Albania	-16.0	-14.0	-9.4	-15.0	-12.8
<hr/>					
Averages:					
CEE & NIS	-7.6	-7.1	-4.4	-4.7	-5.4
CEE	-3.4	-2.6	-3.0	-2.8	-2.8
NIS	-9.2	-9.0	-4.9	-5.4	-6.4
EU		-5.8	-5.2	-4.5	-5.2
EU (Maastricht) target					-3.0
Benchmark					-3.0

¹EBRD, *Transition Report 1996* (November 1996), World Bank, *Country Briefs* (April 1996), and IMF, *World Economic Outlook* (October 1996). General government balance (central gov't balance for Croatia & Turkmenistan).

Table 11. Private Sector Share of GDP & Domestic Investment¹

	Gross Domestic Investment						Private Sector Output in 1996 (% GDP)
	1980	1990	1994	1995	90-94/5	94-95	
	(% GDP)				(% change)		
Czech R.	--	28.6	20.4	--	-33	--	75
Albania	34.5	28.9	13.5	16.2	-56	18	75
Estonia	28.5	30.2	33.0	--	9	--	70
Hungary	30.7	25.4	21.5	22.5	-12	5	70
Slovak R.	37.3	33.5	17.1	17.8	-61	4	70
Lithuania	31.2	34.3	--	16.5	-70	--	65
Poland	26.4	25.6	15.9	18.3	-33	14	60
Latvia	25.7	40.1	11.0	--	-114	--	60
Romania	39.8	30.2	26.9	25.7	-16	-5	60
Russia	22.4	30.1	27.0	28.0	-7	4	60
Croatia	--	13.4	13.8	--	3	--	50
Macedonia	--	32.0	18.0	13.5	-81	-29	50
Armenia	28.5	47.1	10.2	9.4	-133	-8	50
Georgia	--	--	--	3.6	--	--	50
Kyrgyz Rep.	28.7	23.8	--	--	--	--	50
Slovenia	--	16.9	20.8	24.9	38	18	45
Bulgaria	34.0	25.6	20.8	20.9	-20	0	45
Kazakstan	37.6	42.6	24.0	22.0	-64	-9	40
Moldova	--	--	7.7	5.4	--	-35	40
Ukraine	--	27.5	--	8.9	-102	--	40
Uzbekistan	31.6	32.2	23.3	22.4	-36	-4	40
Azerbaijan	23.3	27.8	22.5	23.4	-17	4	25
Tajikistan	30.0	23.4	--	17.8	-27	--	20
Turkmenistan	28.5	40.0	--	--	--	--	20
Belarus	19.5	27.4	--	25.2	-8	--	15
CEE & NIS	27.0	29.6	23.4	21.7	-32	3	53
CEE ave.	31.7	27.3	19.6	20.6	-29	6	62
NIS ave.	24.9	30.5	25.5	22.1	-34	1	49
EU ave.			18		Benchmarks:		
OECD ave.			19		(a) 50% of GDP in private sector		
LDCs aves.:			27		(b) GDI is 18% of GDP		
Sub S.Africa			17		(c) no dom. investment decline		
East Asia & Pac.			36				

¹EBRD, *Transition Report 1996* (November 1996), World Bank, *World Development Report 1996* (June 1996), and World Bank, *Country Briefs* (April 1996).

Table 12. Labor Productivity¹

Labor Productivity in Industry								
	<u>1990</u>	<u>1991</u>	(% change)				<u>1996 (1Q)</u>	'95/89 ² (%)
			<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>		
CEE:								
Hungary	0.4	-17.9	10.7	18.5	7.3	11.2	7.2	130
Poland	-21.1	-11.9	17.1	14.5	19.2	9.6	9.7	122
Bulgaria	-10.4	-11.1	0.2	5.5	14.2	9.0	2.3	105
Slovenia	-9.0	-1.0	-1.0	5.0	10.0	--	--	103
Czech R.	-0.4	-16.6	-7.6	-3.5	4.0	20.5	10.3	93
Croatia	-10.0	-14.0	-1.0	-2.0	2.0	--	--	77
Romania	-24.6	-18.5	-12.3	9.0	11.6	15.7	10.4	76
Slovak R.	--	--	7.4	0.6	6.8	4.0	5.5	--
NIS:								
Ukraine	0.0	-5.0	-1.0	-1.0	-18.0	--	--	76
Russia	1.0	-5.0	-12.0	-14.2	-13.6	4.7	-0.6	66

¹EBRD, *Transition Report 1996* (November 1996), and World Bank, *World Development Report 1996* (June 1996). Output per employee in industry.

²1994 productivity relative to 1989 in the case of Croatia, Slovenia, and Ukraine.

Table 13. Integration into the World Economy¹

	Export Growth (%)	Current Account Balance (% GDP)	Foreign Direct Invest. (% GDP)	Debt Service (% exports)	Institutional Integration ² (memberships)
Czech R.	14.0	0.0	13.0	13.1	(1) (2) (3)
Hungary	11.6	-7.6	31.0	45.1	(1) (2) (3)
Poland	17.6	-1.4	7.0	6.3	(1) (2) (3)
Romania	24.1	-2.6	3.0	12.3	(2) (3)
Slovak R.	15.3	4.5	4.0	9.1	(2) (3)
Slovenia	5.8	1.8	3.0	5.4	(2) (3)
Bulgaria	7.3	-0.1	4.0	17.1	(3)
Estonia	25.9	-7.2	14.0	0.6	(3)
Latvia	6.5	-2.7	5.0	2.1	(3)
Lithuania	13.2	-3.9	1.5	2.5	(3)
Albania	32.9	-11.5	12.5	16.3	
Croatia	12.4	0.0	--	4.2	
Macedonia	7.8	-6.1	2.0	10.1	
Armenia	8.6	-31.0	0.2	19.7	
Azerbaijan	-5.6	-12.6	2.0	14.0	
Belarus	14.1	-6.7	0.2	4.7	
Georgia	-12.5	-25.7	--	28.6	
Kazakhstan	-6.0	-5.2	4.0	6.5	
Kyrgyz R.	0.6	-16.1	0.5	22.0	
Moldova	19.8	-4.9	2.0	14.1	
Russia	5.0	0.7	1.0	24.9	
Tajikistan	-3.8	-8.5	1.0	24.6	
Turkmenistan	6.0	4.0	--	13.0	
Ukraine	-1.6	-5.6	1.0	7.1	
Uzbekistan	13.5	0.1	1.0	3.1	
<hr/>					
CEE & NIS	7.4	-2.6	3.3	16.0	
CEE ave.	16.8	-2.1	8.5	12.4	
NIS ave.	3.6	-2.9	1.2	17.5	
EU ³ ave.	4.1	1.0			
OECD ave.	5.0	0.0			
LDCs ave.				16.6	

Benchmarks (a) 3 yr ave. export growth >4%; (b) 3 yr. current acct bal. no worse than -5%; (c) debt service less than 20%.

¹World Bank, *Country Briefs* (April 1996), World Bank, *World Development Report 1996* (June 1996), and EBRD, *Transition Report 1996* (Nov. 1996). Export growth and Current account balance indicators are for 1994-1995; FDI: 1989-1995 FDI as % of 1994 GDP; debt service: 1995.

²Members of or participants in: OECD (1); WTO (2); Europe Agreements with EU (3); NATO (4).

³For EU and OECD, it is 1990-94 export growth, & 1994 current account balance; for LDCs, 1994 debt service.

2. Social Conditions

Ultimately, the sustainability of the transition hinges on the well-being of the individual. There are important humanitarian considerations. However, equally if not more compelling are the links between living standards, popular expectations, and the level of public support for economic and political reforms--reforms which have coincided with, if not contributed to, both a dramatic initial drop in overall income and significant increases in income inequalities and poverty.

Tables 14 through 19 highlight social conditions. Unemployment needs to be a concern. It is a new phenomenon for the region, and, as *Table 14* highlights, it is significant, at least in CEE. While the unemployment rate in CEE may have peaked in 1993, the CEE average remains, as of 1995, in double digits. In addition, the three Baltic states are significantly pulling down this average. Yet, these figures are suspiciously low, and likely reflect in part the relatively flawed system of data collection inherited from the Soviet Union.

With that caveat in mind, the CEE's eleven percent unemployment rate in 1995, nevertheless, is on par with that in the EU. Virtually all the countries have been experiencing a decline in unemployment since 1993. Latvia and Lithuania are two exceptions, though the increase in these cases may reflect more than anything an improvement in data collection. Macedonia's unemployment is very high; almost one in three persons in the labor force was unemployed in 1994. Further, this is an increase from 1993.

The official unemployment figures in the NIS are generally much lower than in CEE. This may reflect a combination of phenomena. One may be poorer data collection techniques. More significant is likely to be the tendency for labor markets to adjust differently in the NIS at this point in the transition. In short, underemployment (in the form of fewer work hours, involuntary leave and wage arrears) in the NIS may to some extent exist in lieu of greater open unemployment. The degree of open unemployment currently experienced in CEE may be a reflection of what is to come in the NIS. Similarly, the lower open unemployment in the NIS may be an indication of less progress in the restructuring process.

While the number of unemployed in CEE has not changed dramatically from year to year, a critical consideration is whether these figures represent the same people. In other words, how long are people typically unemployed? With safety nets disappearing, we know that unemployment is a crucial determinant towards poverty.

Monitoring long-term unemployment is hence important, and *Table*

15 addresses this aspect in part. Many data gaps exist and we can only sketch a rough picture. Of the seven countries for which data are available, long-term unemployment would seem to be particularly troublesome for three: Macedonia, Albania, and Bulgaria. In 1992, eighty-five percent of those unemployed in Macedonia were unemployed for more than one year. With very high total unemployment, this translates into very high long-term unemployment: twenty-two percent in 1992. Extrapolating from evidence from other countries, the proportion of long-term unemployed to total unemployed in Macedonia is likely higher today.

In 1993, fifteen percent of Albania's labor force (or sixty-five percent of all those unemployed) had been unemployed for more than one year. Nine percent of Bulgaria's labor force in 1993 (or almost seventy percent of all those unemployed) had been unemployed for more than one year. These are fairly significant proportions of the population which are presumably not going to vote for the continuation of the status quo come election time.

Those countries for which time series are available (Hungary, Poland, Romania, and Slovak Republic) show an increase in long-term unemployment as a share of the total unemployed. Except for the Slovak Republic, this increase is substantial, particularly given that it is over a short period of time (1992-1994). This trend may need to be closely watched.

Table 16 sheds light on living standards through indicators of income. The first observation is that the average incomes in CEE and the NIS are significantly below the EU average: CEE per capita income is one-third of that found in the EU; in the NIS it is one-fifth. Furthermore, average income varies widely within ENI: from roughly \$10,000 in Slovenia and the Czech Republic, to close to \$1,000 in Albania, Azerbaijan, Georgia, and Tajikistan.

What may be more important for our purposes is how the income levels have changed during the transition, and how it has been distributed. Other things equal, the greater the income disparities and collapse in incomes, the more pronounced are the hardships and the greater is the likelihood of "reform fatigue".

In this regard, it is significant to note (as shown in Table 16) that only Poland has regained its pre-transition income level. Slovenia is close behind. For the CEE region as whole, 1996 income is almost ninety percent of 1989 income. Three CEE countries--Macedonia, Latvia, and Lithuania--have incomes significantly below pre-transition levels. This likely translates into significant hardships for some. For the NIS, 1996 income relative to income in 1989 is considerably lower still; roughly one-half the pre-transition level.

We can fill in the picture further with income distribution data. In general, while income inequality has increased dramatically over the transition, the degree of inequality for most transition countries is below that found in most other regions of the world. These were highly egalitarian societies prior to the collapse of communism.

In CEE overall, the twenty percent of the population with the highest income receives roughly four times as much as the poorest twenty percent. This compares to a seven-to-one ratio in the OECD, and, where global inequality remains the highest, nineteen-to-one in Latin America.

The income distribution in Russia, in contrast, is perhaps as unequal as anywhere in the world. In fact by gini coefficient measures, income inequality in Russia is comparable to that found in Brazil.

Poverty has increased substantially in ENI as shown in Table 16. In fact, these poverty estimates tend to be quite low relative to some others. UNICEF, for example, cites a percentage point increase in poverty rates from 1989 to 1994 in: Lithuania by 64.7 percent; Latvia by 55.1 percent; Moldova by 54.9 percent; Azerbaijan by 50 percent; Bulgaria by 49.7 percent; Estonia by 46.0 percent; Russia by 45.5 percent; Romania by 31.7 percent; Slovak Republic by 27.2 percent; Czech Republic by 22.5 percent; Hungary by 12.4 percent; and Poland by 12.2 percent.⁸

Overall, according to World Bank estimates, one in three persons in ENI are poor. This average masks very wide variation, however. Poverty remains negligible in Slovenia, the Czech Republic, and the Slovak Republic. In contrast, roughly one out of two persons are considered poor by this standard in Turkmenistan, Kazakhstan, and Lithuania. The ratio is apparently even higher in the Kyrgyz Republic and Moldova.

One reason why the poverty estimates vary widely is because the poverty is apparently shallow in most of the region.⁹ That is, many of the poor are only marginally so, and a relatively small change in the poverty line, can result in a relatively large

⁸UNICEF, *Poverty, Children and Policy: Responses for a Brighter Future*, Economies in Transition Studies, Regional Monitoring Report No. 3 (1995). If Lithuania's poverty rate in 1989 was 5%, its 1994 poverty rate by this count would be 70%.

⁹In contrast to the general trend, however, a forthcoming World Bank study on poverty in Romania will presumably reveal few but deep pockets of poverty in Romania.

change in the poverty rate.¹⁰ There may be a significant turnover among those found in poverty as well.¹¹ Both trends have favorable implications for policy; both need to be explored further.

Table 17 highlights trends in infant mortality and life expectancy. The news is mixed and widely varied. Infant mortality has decreased in both CEE and the NIS from 1991 to 1994, though the averages mask wide variations. While infant mortality decreased by roughly twenty percent in this time period in the Czech Republic, Uzbekistan, Slovenia, and Hungary, it increased in eight ENI countries; including a twenty percent increase in Georgia, thirteen percent in Moldova, and seven percent in Belarus. Infant mortality levels also vary much: from forty-six and forty-one deaths per 1,000 live births in Turkmenistan and Tajikistan, respectively, to close to the EU average of six in Slovenia and the Czech Republic.

Life expectancy in CEE is seventy-one years, six years below the EU average. More significant may be the registered increase, albeit slight, in life expectancy in CEE since 1991. As elaborated in a recent Bureau of Census report, the downward regional trend in life expectancy, which was experienced in the early transition years by all the countries of CEE except for the Czech Republic and Macedonia, has stopped.¹² Still, three CEE countries--Romania, Lithuania, and Latvia--experienced a decline in life expectancy between 1991 and 1994.

By contrast, life expectancy in the NIS continues to decline for most of the countries, though Russia, with a five percent decline since 1991, is significantly pulling down the regional average. Five NIS countries, nevertheless, witnessed an increase in life expectancy: Moldova, Armenia, Turkmenistan, Uzbekistan, and Georgia.

As with physical capital, the stock of human capital or the level

¹⁰A World Bank study cites an increase in poverty in Hungary from 2% in 1989 to over 8% in 1993, using the minimum pension as the poverty line. A poverty line set at roughly one and half times the minimum pension, however, translates into a poverty rate from less than 5% in 1989 to anywhere from 33-40% in 1993. World Bank, *Hungary: Poverty and Social Transfers* (March 14, 1996).

¹¹This conclusion at any rate would seem to apply to Russia. See: World Bank, *Poverty in Russia: An Assessment*, Human Resources Division, June 1995.

¹²Bureau of Census, *Populations at Risk in CEE: Health Trends*, No. 4, prepared for ENI/PCS/PAS (June 1996).

of education of the population, is important for its direct effect on economic sustainability. It too, however, can provide indications of trends in living standards. Table 18 provides some evidence, though many data gaps exist. In particular, the secondary school enrollment percentages remain quite high in the region, and not far from that found in the EU. Secondary school enrollment may actually be higher in the NIS than in CEE. Macedonia is the outlier: roughly one in two secondary school age children were not enrolled in school in Macedonia in 1993.

While there has been some concern that enrollments may be deteriorating in the region, the evidence provides a mixed picture. Of the eight countries for which time series data are available, enrollments have increased between 1990 and 1993 in four of them. However, three countries may have experienced significant declines: Ukraine by fifteen percent; Russia and Bulgaria by seven percent.

Finally, Table 19 sheds some light on environmental developments. Environmental degradation was pervasive under central planning. A focus on maximizing production with little or no regard for environmental consequences and with a strong emphasis on heavy industry and highly energy-intensive methods contributed to much of this. Obviously, quality of life and support for the transition are part of the issue here. However, increasing productivity and efficiency are also important.

Integral to this for the CEE countries in particular is membership into the EU which will require gradual adaption of the EU's environmental regulations. Substantial investments will likely need to accompany the establishment of a viable regulatory regime and appropriate energy prices. A 1993 study of six CEE countries (Bulgaria, the Czech Republic, Hungary, Poland, Romania, and the Slovak Republic) estimated environmental investments of fifteen to twenty percent of GDP to bring them up to EU standards.¹³

While we have far to go towards better monitoring the environment in the transition economies, Table 19 fills in a small part of the picture by addressing in part environmental efficiency and quality. More efficient use of natural resources (that is, greater environmental efficiency) should translate into lower pollution, at least on a unit of production basis. Energy and water use intensity seem to be reasonable measures of this efficiency.

¹³Environmental Resource Management, *Environmental Standards and Legislation in Western and Eastern Europe: Towards Harmonisation*, Final Report prepared for EBRD/EU-Phare, December 1993.

For this measure, electricity intensity of output in 1994 is examined. The electric power sector is a major source of air pollution in ENI, particularly in those countries that rely primarily on coal, lignite, and oil shale as their primary energy source.

Table 19 reveals substantial differences in electricity intensity of output in 1994 between the ENI countries and the industrial market economies, as well as within ENI. Electricity intensity in CEE is twice as high as that found in the EU; in the NIS, it is more than three times higher. Electricity intensity is highest in ENI in the Central Asian Republics and Azerbaijan where energy resources are plentiful. Electricity intensity is highest among CEE countries in Bulgaria and Lithuania which rely heavily on nuclear power generation (and where nuclear safety needs to be a big concern).

Table 19 also shows annual mean concentrations of three common air pollutants--sulphur dioxide, nitrogen dioxide, and total suspended particulates--in parts per million for major cities in eighteen ENI and eight Western Europe countries for the period 1990-1992. Such emissions are used as proxies for environmental quality. Bearing in mind the many data gaps, and widely varying results per city, the regional averages in sulphur dioxide and nitrogen dioxide emissions in the early transition years are roughly comparable between ENI and the EU. In contrast, TSP concentrations were twice as high in ENI vis-a-vis Western Europe.

A 1994 Bureau of Census study reported a decrease in air pollution emissions in several CEE countries (with the apparent exception of the Czech Republic) in the early transition years.¹⁴ Such a trend, however, is likely attributed in large part to an overall drop in production. More recent figures might reveal increasing pollution coinciding with economic growth.

¹⁴Bureau of Census, *Populations at Risk in CEE: An Overview*, No. 1, prepared for USAID/ENI/PCS (November 1994).

Table 14. Unemployment rate¹

	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>'93-95 ave.</u>
CEE:					
Czech Rep.	2.6	3.5	3.2	2.9	3.2
Lithuania	1.3	4.4	3.8	6.2	4.8
Estonia	--	5.0	5.1	5.0	5.0
Latvia	2.3	5.8	6.5	6.6	6.3
Romania	8.1	10.2	11.0	8.9	10.0
Hungary	12.3	12.1	10.4	10.4	11.0
Croatia	12.9	12.8	12.8	13.4	13.0
Bulgaria	15.6	16.4	12.8	10.5	13.2
Slovak Rep.	10.3	14.4	14.8	13.1	14.1
Slovenia	11.6	14.4	14.4	13.9	14.2
Poland	13.6	15.7	16.0	14.9	15.5
Albania	30.3	22.4	19.2	13.0	18.2
Macedonia	26.2	27.7	29.0	---	27.6
NIS:					
Armenia	19.0	26.0	--	8.0	17.0
Azerbaijan	--	--	--	--	--
Belarus	0.5	1.4	2.1	2.8	2.1
Georgia	5.4	8.4	--	--	--
Kazakhstan	0.5	0.6	1.6	2.4	1.5
Kyrgyz Rep.	--	--	--	--	--
Moldova	--	--	--	--	--
Russia	--	5.5	7.1	8.2	6.9
Tajikistan	--	--	--	--	--
Turkmenistan	--	--	--	--	--
Ukraine	0.3	0.4	0.4	0.6	0.5
Uzbekistan	0.1	0.2	0.4	0.4	0.3
CEE average	11.3	12.7	12.4	11.3	12.1
Industrial Countries	7.8	8.2	8.1	7.7	8.0
U.S.	7.5	6.9	6.1	5.6	5.6
EU average	9.9	11.1	11.6	11.2	11.3
Benchmarks				11.0	14.0

¹EBRD, *Transition Report 1996* (November 1996), IMF, *World Economic Outlook* (October 1996), and Bureau of Census, *Populations at Risk in CEE: Labor Markets*, No. 2, prepared for ENI/PCS/PAS (February 1995).

Table 15. Long-term Unemployment in CEE¹

	(% of labor force)			(% share of total unemployed)			Percent Change
	1992	1993	1994	1992	1993	1994	
Albania	--	14.6	--	--	65	--	--
Bulgaria	--	8.9	--	--	69	--	--
Croatia	--	--	--	--	--	--	--
Czech R.	--	--	--	--	--	--	--
Estonia	--	--	--	--	--	--	--
Hungary	2.3	5.1	--	18	40	--	76
Latvia	--	--	--	--	--	--	--
Lithuania	--	--	--	--	--	--	--
Macedonia	22.3	--	--	85	--	--	--
Poland	4.5	--	6.7	33	--	42	39
Romania	1.7	--	5.0	21	--	45	97
Slovak R.	--	4.8	5.0	--	33	34	4
Slovenia	--	--	--	--	--	--	--

Benchmark

Long-term unemployment less than 8%
of the labor force

¹Bureau of Census, *Populations at Risk in CEE: Labor Markets*, No. 2, prepared for ENI/PCS/PAS (Feb. 1995). The long-term unemployed are those unemployed for more than one year.

Table 16. *Income & its Distribution*¹

	Average Income	Distribution of Income	Poverty Rates		1996/1989 GDP (%)
			'87-88	'93-95	
Poland	6,160	3.9	6	12	103
Slovenia	9,840	4.0	0	1	94
Czech R.	9,800	3.6	0	1	90
Slovak R.	7,550	2.6	0	1	89
Romania	4,570	3.8	6	32	88
Hungary	6,260	3.9	1	6	87
Uzbekistan	2,320	--	24	29	82
Albania	1,250	--	--	--	81
Bulgaria	4,310	4.7	2	33	73
Croatia	4,130	--	--	--	68
Estonia	4,790	7.0	--	23	66
Turkmenistan	3,560	6.4	12	48	60
Belarus	3,690	3.0	1	11	58
Macedonia	--	--	--	--	56
Russia	4,290	14.5	2	38	53
Latvia	3,200	3.8	1	19	52
Kyrgyz R.	1,790	--	12	76	51
Kazakstan	2,570	5.4	5	50	46
Ukraine	2,150	3.7	2	41	43
Lithuania	3,440	5.2	1	49	41
Armenia	2,460	--	--	--	40
Moldova	3,240	6.0	4	65	39
Tajikistan	790	--	--	--	37
Azerbaijan	1,340	--	--	--	36
Georgia	1,280	--	--	--	20
<hr/>					
CEE & NIS	4,010	8.6	4	33	62
CEE ave.	5,780	3.9	4	17	88
NIS ave.	3,330	10.7	4	39	52
OECD ave.	15,038	6.9			
EU ave.	18,225				
UK			1		
Turkey			31		
Malaysia			15		
Brazil			33		

Benchmark (a) current yr GDP 85% of 1989 GDP

¹World Bank (June 1996); EBRD (November 1996); B. Milanovic, *Poverty, Inequality and Social Policy in Transition Economies*, World Bank (1995); & Bureau of Census, *Populations at Risk*, No. 5, ENI/PCS/PAS (July 1996). Average income: 1994 purchasing power parity per capita income figures (1993 for Albania & Moldova; 1992 for Turkmenistan) were updated to 1996 from real economic growth estimates. Income distribution: income of wealthiest 20% of population to poorest 20%; latest year available. Poverty rates: % of population below poverty line of \$120 at 1990 international prices per cap. per month.

Table 17. Infant Mortality and Life Expectancy¹

	Infant Mortality			Life Expectancy		
	1991-93	1994	Percent Change	1991-93	1994	Percent Change
Slovak Rep.	12.1	11.2	-7.7	71.2	72.3	1.5
Poland	14.3	15.1	5.4	70.9	71.7	1.1
Moldova	19.9	22.6	12.7	67.7	68.3	0.9
Czech Rep.	9.6	7.9	-19.4	72.4	73.0	0.8
Armenia	17.8	15.1	-16.4	70.5	71.1	0.8
Macedonia	27.7	23.8	-15.1	72.1	72.7	0.8
Croatia	11.6	10.9	-6.2	72.9	73.5	0.8
Turkmenistan	45.5	46.4	2.0	65.8	66.3	0.8
Uzbekistan	35.0	28.2	-21.5	69.3	69.8	0.7
Estonia	15.0	14.5	-3.4	69.6	70.1	0.7
Slovenia	7.9	6.5	-19.4	73.2	73.6	0.5
Georgia	14.8	18.3	21.1	72.6	73.0	0.5
Hungary	14.2	11.6	-20.2	69.3	69.6	0.4
Albania	32.1	31.0	-3.5	72.5	72.8	0.4
Bulgaria	16.1	15.3	-5.1	71.0	71.2	0.3
Kyrgyz R.	31.0	29.1	-6.3	67.9	67.8	-0.1
Romania	23.1	23.9	3.4	69.8	69.5	-0.4
Azerbaijan	26.3	25.2	-4.3	69.8	69.4	-0.6
Belarus	12.3	13.2	7.3	69.8	69.3	-0.7
Latvia	16.5	15.5	-6.3	68.8	68.1	-1.0
Kazakstan	27.3	27.4	0.4	69.0	68.3	-1.0
Lithuania	15.6	14.1	-10.1	70.0	68.7	-1.9
Tajikistan	44.5	40.6	-9.2	68.1	66.6	-2.2
Ukraine	14.3	14.3	0.0	69.8	67.9	-2.8
Russia	18.6	18.7	0.5	67.2	64.0	-4.9
CEE & NIS ave.	19.4	18.9	-2.3	69.0	67.6	-2.0
CEE ave.	16.2	16.0	-1.8	70.8	71.2	0.5
NIS ave.	20.6	20.1	-2.5	68.3	66.2	-3.0
LDCs aves.		58			64	
Middle-income		40			67	
OECD ave.		10			76	
EU ave.		6			77	
Benchmarks		30	no worsening		68	no worsening

¹World Bank, *World Development Report 1996* (June 1996). Infant mortality rate is per 1,000 live births; and life expectancy is in years. The OECD infant mortality rate average is significantly pulled up by 2 members: Korea at 62 & Mexico at 35.

Table 18. Human Capital: Secondary School Enrollment¹

	Secondary School enrollment (% of age group)			% change since '90
	<u>1980</u>	<u>1990</u>	<u>1993</u>	
Uzbekistan	--	--	94	--
Belarus	98	93	92	-1
Estonia	--	--	92	--
Romania	71	92	--	--
Kazakstan	--	--	90	--
Slovak R.	--	--	89	--
Slovenia	--	--	89	--
Azerbaijan	--	--	88	--
Russia	96	94	88	-7
Latvia	--	--	87	--
Czech R.	--	--	86	--
Armenia	--	--	85	--
Poland	77	81	84	4
Croatia	--	77	83	8
Hungary	70	79	81	3
Ukraine	94	93	80	-15
Lithuania	--	--	78	--
Albania	67	78	--	--
Moldova	--	--	69	--
Bulgaria	84	73	68	-7
Macedonia	61	53	54	2
Georgia	--	--	--	--
Kyrgyz R.	--	--	--	--
Tajikistan	--	--	--	--
Turkmenistan	--	--	--	--
<hr/>				
CEE & NIS ave.	90	90	80	-6
CEE ave.	75	82	82	3
NIS ave.	96	94	87	-9
EU ave.			90	
Benchmark	no enrollment decline			

¹World Bank, *World Development Report 1996* (June 1996) & UNDP, *Human Development Report 1996* (July 1996). OECD data are for 1992; data not available for Austria, Italy, Luxembourg, & Portugal.

Table 19. Environment¹

		Quality Air Pollution Concentrations			Efficiency Electricity Intensity
	City	SO2	NO2	TSP	
Albania	(Tirana)	23	--	85	400
Latvia	(Riga)	4	60	100	450
Croatia	(Zagreb)	39	--	67	540
Hungary	(Budapest)	44	44	62	550
Slovenia	(Ljubljana)	50	54	23	600
Poland	(Warsaw)	30	54	--	650
Poland	(Krakow)	47	31	54	650
Belarus	(Minsk)	20	37	100	700
Armenia	--	--	--	--	700
Slovak R.	(Bratislava)	20	--	58	700
Czech R.	(Prague)	75	56	84	710
Estonia	--	--	--	--	750
Romania	(Bucharest)	40	36	130	840
Moldova	(Chisinau)	2	20	--	850
Uzbekistan	--	--	--	--	860
Lithuania	(Vilnius)	--	27	--	950
Bulgaria	(Sofia)	31	53	170	1000
Russia	(Moscow)	--	76	100	1100
Russia	(St.Peters)	5	58	90	1100
Ukraine	(Kiev)	13	50	100	1180
Ukraine	(Odessa)	44	97	270	1180
Macedonia	--	--	--	--	1200
Georgia	--	--	--	--	1300
Kyrgyz R.	--	--	--	--	1300
Azerbaijan	--	--	--	--	1400
Kazakstan	--	--	--	--	1400
Turkmenistan	--	--	--	--	1900
Tajikistan	--	--	--	--	2005
<hr/>					
Averages:					
CEE & NIS		30	50	100	1010
CEE		37	46	83	720
NIS		--	--	--	1130
EU		23	55	50	350
U.S. & Canada		--	--	--	550

¹EBRD, *Transition Report 1996* (November 1996). Air pollution concentrations are annual mean concentrations of sulphur dioxide (SO2), nitrogen dioxide (NO2), and total suspended particulates (TSP) in parts per million for major cities for the period 1990-92. EU aves. are based on widely varying concentrations in cities in 8 countries. Electricity intensity refers to 1994 electricity consumption per US\$ 1,000 of GNP at PPP exchange rates (1993 for Tajikistan, Turkmenistan, Georgia, Uzbekistan, and Albania).

IV. Concluding Remarks

Decisions on the magnitude and duration of U.S. assistance to the ENI region are made on the basis of several factors:

- (a) progress the country has made toward a sustainable transition to a market-based democracy;
- (b) strategic importance of the country to the United States;
- (c) importance of the recipient country to U.S. citizens; and
- (d) effectiveness of particular assistance activities.

This paper has presented an approach to analyzing the first factor. The second and third are not as readily quantifiable but are matters of judgment that are regularly considered, along with the first, in making country-level budget decisions. The fourth factor, based on both regular reporting against strategic objective targets and on occasional field-based evaluations, is used primarily to inform the allocation of country budget levels among strategic objectives but is also a basis for determining whether a country assistance program is having enough impact to warrant continuation.

USAID will collect, analyze, and report on the country performance indicators two times a year: (a) each winter prior to the spring USAID review of mission strategies and USAID performance monitoring (and subsequent to EBRD's annual update of its economic policy indicators); and (b) each summer after Freedom House presents its annual democracy ratings. These data will also be provided to the State Department-based Coordinators for U.S. Assistance to CEE and the NIS and discussed with them when country planning levels are determined.

The overall rankings of the ENI countries in terms of economic policy reforms and democratic freedoms (as depicted in Table 7) provide a rough guide to policy in this regard. Countries ranked near the top of the list are obvious candidates for earlier "graduation". Countries near the bottom of the list would seem to fall into one of three contrasting categories: (1) those where assistance is least likely to be effective, in which case it may make sense to close those programs down altogether or to keep highly targeted funding at minimal levels until their commitment to reform increases; (2) those where reform now appears likely but requires greater resources; or (3) those which possess characteristics that match well with the Agency's priorities for sustainable development programs. Countries in the middle of the list are likely candidates for continuing programs through existing funding mechanisms, as long as the assistance is effective and Congress continues to appropriate funds for this

purpose.

In addition, by looking beyond the aggregate rankings and developing a decision tree methodology, this paper attempts to more rigorously devise criteria towards graduation from U.S. assistance. First, do the countries achieve some acceptable level of progress in both economic policy reforms and democratization? Acceptable thresholds must occur in both before we consider sustainability.

Next, are the economic policy reforms translating into robust and sustainable macroeconomic outcomes? In addition, are trends in the social conditions such that the economic and political reforms are not likely to be thwarted or side-tracked?

Finally, an application of the decision tree methodology in concert with the proposed graduation benchmarks leads to the conclusion that there is likely a handful of current leading contenders for graduation from USAID assistance in CEE. Further elaboration and interpretation of how each country of the region scores overall in this regard is an important objective of the review process, both in-house and outside USAID.

APPENDIX I

A. *Economic Policy Reforms: Indicators & Description of EBRD's Rating Categories*

First Round Reforms:

Small-scale Privatization

- 1 Little progress
- 2 Substantial share privatized
- 3 Nearly comprehensive programme implemented, but design or lack of government supervision leaves important issues unresolved (e.g. lack of tradability of ownership rights)
- 4 Complete privatization of small companies with tradable ownership rights
- 5 Standards and performance typical of advanced industrial economies: no state ownership of small enterprises; effective tradability of land

Price Liberalization

- 1 Most prices formally controlled by the government
- 2 Price controls for several important product categories, including key infrastructure products such as utilities and energy; state procurement at non-market prices remains substantial
- 3 Substantial progress on price liberalization including for energy prices; state procurement at non-market prices largely phased out
- 4 Comprehensive price liberalization; utility pricing ensuring cost recovery
- 5 Standards and performance typical of advanced industrial economies: comprehensive price liberalization; efficiency-enhancing regulation of utility pricing

Trade & Foreign Exchange System

- 1 Widespread import and/or export controls or very limited legitimate access to foreign exchange
- 2 Some liberalization of import and/or export controls; almost full current account convertibility in principle but with a foreign exchange regime that is not fully transparent (possibly with multiple exchange rates)
- 3 Removal of most quantitative and administrative import and export restrictions (apart from agriculture) and all significant export tariffs; insignificant direct involvement in exports and imports by ministries and state-owned trading companies; no major non-uniformity of customs duties for non-agricultural goods and services.
- 4 Removal of all quantitative and administrative import and export restrictions (apart from agriculture) and all significant export tariffs; insignificant direct involvement

in exports and imports by ministries and state-owned trading companies; no major non-uniformity of customs duties for non-agricultural goods and services

- 5 Standards and performance norms of advanced industrial economies: removal of most tariff barriers; membership in GATT/WTO

Second Round Reforms:

Large-scale Privatization

- 1 Little progress
- 2 Comprehensive scheme almost ready for implementation; some sales completed
- 3 More than 25 percent of large-scale state-owned enterprise assets privatized or in the process of being sold, but possibly with major unresolved issues regarding corporate governance
- 4 More than 50 percent of state-owned enterprise assets privatized in a scheme that has generated substantial outsider ownership
- 5 Standards and performance typical of advanced industrial economies: more than 75 percent of enterprise assets in private ownership with effective corporate governance

Enterprise Restructuring

- 1 Soft budget constraints (lax credit and subsidy policies weakening financial discipline at the enterprise level); few other reforms to promote corporate governance
- 2 Moderately tight credit and subsidy policy but weak enforcement of bankruptcy legislation and little action taken to break up dominant firms
- 3 Significant and sustained actions to harden budget constraints and to promote corporate governance effectively (e.g. through privatization combined with tight credit and subsidy policies and/or enforcement of bankruptcy legislation)
- 4 Strong financial discipline at the enterprise level; substantial improvement in corporate governance through government restructuring programme or an active corporate control market; significant action to break up dominant firms
- 5 Standards and performance typical of advanced industrial economies: effective corporate control exercised through domestic financial institutions and markets, fostering market-driven restructuring

Third Round Reforms:

Competition Policy

- 1 No competition legislation and institutions; widespread entry restrictions
- 2 Competition policy legislation and institutions set up; some

- reduction of entry restrictions or enforcement action on dominant firms
- 3 Some enforcement actions to reduce abuse of market power and to promote a competitive environment, including break-ups of dominant conglomerates; substantial reduction of entry restrictions
 - 4 Significant enforcement actions to reduce abuse of market power and to promote a competitive environment
 - 5 Standards and performance typical of advanced industrial economies: effective enforcement of competition policy; unrestricted entry to most markets

Banking Reform

- 1 Little progress beyond establishment of a two-tier system
- 2 Significant liberalization of interest rates and credit allocation; limited use of directed credit or interest rate ceilings
- 3 Substantial progress in establishment of bank solvency and of a framework for prudential supervision and regulation; full interest rate liberalization with little preferential access to cheap refinancing; significant lending to private enterprises and significant presence of private banks
- 4 Significant movement of banking laws and regulations towards BIS standards; well-functioning banking competition and effective prudential supervision; significant term lending to private enterprises; substantial financial deepening
- 5 Standards and performance norms of advanced industrial economies: full convergence of banking laws and regulations with BIS standards; provision of full set of competitive banking services

Non-Bank Financial Institutional Reform

- 1 Little progress
- 2 Formation of securities exchanges, market-makers and brokers; some trading in government paper and/or securities; rudimentary legal and regulatory framework for the issuance and trading of securities
- 3 Substantial issuance of securities by private enterprises; establishment of independent share registries, secure clearance and settlement procedures, and some protection of minority shareholders; emergence of non-bank financial institutions (e.g. investment funds, private insurance and pension funds, leasing companies) and associated regulatory framework
- 4 Securities laws and regulations approaching IOSCO standards; substantial market liquidity and capitalisation; well-functioning non-bank financial institutions and effective regulation
- 5 Standards and performance norms of advanced industrial economies: full convergence of securities laws and regulations with IOSCO standards; fully developed non-bank intermediation

AB

Legal Reform for Investment

- 1 Legal rules often very unclear and impose significant constraints to creating investment vehicles, security interests or repatriation of profits; availability of legal advice is limited; judicial and administrative support of the law is substantially deficient
- 2 Legal rules often unclear; legal advice often difficult to obtain; legal rules impose constraints to creating investment vehicles, the taking of security or repatriation of profits; judicial and administrative support of the law is rudimentary; where adequate legal rules or legal advice exist, administration of the law is deficient
- 3 Legal rules do not impose major obstacles to the creation of investment vehicles, the taking of security or the export of profits; legal rules are reasonably clear and specialised legal advice is available; judicial and administrative support of the law is often inadequate; where such support is adequate, legal rules often impose significant constraints
- 4 Legal rules are clear, generally do not discriminate between foreign and domestic investors and impose few constraints; specialised legal advice readily available; investment laws reasonably well administered and supported judicially, although that support is sometimes patchy
- 5 Legal rules closely approximate generally accepted standards internationally and are readily ascertainable through sophisticated legal advice; investment laws are well administered and supported judicially, particularly regarding functioning of courts and land and the orderly and timely registration of proprietary or security interests.

B. Democratic Freedoms: Elaboration of Freedom House's Rating Scheme of Political Rights and Civil Liberties

Freedom House annually rates political rights and civil liberties separately on a seven-category scale, 1 representing the most free and 7 the least free. The 1995-1996 Survey included 191 countries and/or territories. The 1-to-7 rating is derived by country teams awarding from 0 to 4 raw points per checklist item (shown below). The highest possible score for political rights is 32 points, based on up to 4 points for each of eight questions. The highest possible score for civil liberties is 52 points, based on up to 4 points for each of thirteen questions. Under the methodology, raw points correspond to category numbers as follows:

<u>Political Rights category number</u>	<u>Raw points</u>
1	28-32
2	23-27
3	19-22
4	14-18
5	10-13
6	5-9
7	0-4

<u>Civil Liberties category number</u>	<u>Raw points</u>
1	45-52
2	38-44
3	30-37
4	23-29
5	15-22
6	8-14
7	0-7

Political Rights checklist

1. Is the head of state and/or head of government or other chief authority elected through free and fair elections?
2. Are the legislative representatives elected through free and fair elections?
3. Are there fair electoral laws, equal campaigning opportunities, fair polling and honest tabulation of ballots?
4. Are the voters able to endow their freely elected representatives with real power?
5. Do the people have the right to organize in different political parties or other competitive political groupings of their choice, and is the system open to the rise and fall of these competing parties or groupings?
6. Is there a significant opposition vote, de facto opposition power, and a realistic possibility for the opposition to increase its support or gain power through elections?
7. Are the people free from domination by the military, foreign powers, totalitarian parties, religious hierarchies, economic oligarchies or any other powerful group?
8. Do cultural, ethnic, religious and other minority groups have reasonable self-determination, self-government, autonomy or participation through informal consensus in the decision-making process?

Civil Liberties checklist

1. Are there free and independent media, literature and other cultural expressions? (Note: In cases where the media are state-controlled but offer pluralistic points of view, the Survey gives

the system credit).

2. Is there open public discussion and free private discussion?
3. Is there freedom of assembly and demonstration?
4. Is there freedom of political or quasi-political organization?
(Note: This includes political parties, civic associations, ad hoc groups and so forth.)
5. Are citizens equal under the law, with access to an independent, nondiscriminatory judiciary, and are they respected by the security forces?
6. Is there protection from political terror, and from unjustified imprisonment, exile or torture, whether by groups that support or oppose the system, and freedom from war or insurgency situations? (Note: Freedom from war and insurgency situations enhances the liberties in a free society, but the absence of wars and insurgencies does not in itself make an unfree society free.)
7. Are there free trade unions and peasant organizations or equivalents, and is there effective collective bargaining?
8. Are there free professional and other private organizations?
9. Are there free businesses or cooperatives?
10. Are there free religious institutions and free private and public religious expressions?
11. Are there personal social freedoms, which include such aspects as gender equality, property rights, freedom of movement, choice of residence, and choice of marriage and size of family?
12. Is there equality of opportunity, which includes freedom from exploitation by or dependency on landlords, employers, union leaders, bureaucrats or any other type of denigrating obstacle to a share of legitimate economic gains?
13. Is there freedom from extreme government indifference and corruption?

Political Rights

1 Rating. Generally speaking, places rated 1 come closest to the ideals suggested by the checklist questions, beginning with free and fair elections. Those elected rule. There are competitive parties or other competitive political groupings, and the opposition has an important role and power. These entities have self-determination or an extremely high degree of autonomy. Usually, those rated 1 have self-determination for minority groups or their participation in government through informal consensus. With the exception of such entities as tiny island countries, these countries and territories have decentralized political power and free sub-national elections.

2 Rating. Such factors as gross political corruption, violence, political discrimination against minorities, and foreign or military influence on politics may be present, and weaken the quality of democracy.

3,4, and 5 Ratings. The same factors that weaken freedom in category 2 may also undermine political rights in categories 3,4, and 5. Other damaging conditions may be at work as well, including civil war, very strong military involvement in politics, lingering royal power, unfair elections and one-party dominance. However, states and territories in these categories may still have some elements of political rights such as the freedom to organize nongovernmental parties and quasi-political groups, reasonably free referenda, or other significant means of popular influence on government.

6 Rating. Typically, such states have systems ruled by military juntas, one-party dictatorships, religious hierarchies and autocrats. These regimes may allow only some minimal manifestation of political rights such as competitive local elections or some degree of representation or autonomy for minorities. Category 6 also contains some countries in the early or aborted stages of democratic transition. A few states in Category 6 are traditional monarchies that mitigate their relative lack of political rights through the use of consultation with their subjects, toleration of political discussion, and acceptance of petitions from the ruled.

7 Rating. This includes places where political rights are absent or virtually nonexistent due to the extremely oppressive nature of the regime or extreme oppression in combination with civil war. A country or territory may also join this category when extreme violence and warlordism dominate the people in the absence of an authoritative, functioning central government.

Civil Liberties

1 Rating. This includes countries and territories that generally have the highest levels of freedoms and opportunities for the individual. Places in this category may still have problems in civil liberties, but they lose partial credit in only a limited number of areas.

2 Rating. Places in this category, while not as free as those in 1, are still relatively high on the scale. These countries have deficiencies in several aspects of civil liberties, but still receive most available credit.

3, 4, and 5 Ratings. Places in these categories range from ones that receive at least partial credit on virtually all checklist questions to those that have a mixture of good civil liberties scores in some areas and zero or partial credit in others. As one moves down the scale below category 2, the level of oppression increases, especially in the areas of censorship, political terror and the prevention of free association. There are also many cases in which groups opposed to the state carry

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out political terror that undermines other freedoms. That means that a poor rating for a country is not necessarily a comment on the intentions of the government. The rating may simply reflect the real restrictions on liberty which can be caused by non-governmental terror.

6 Rating. Typically, at category 6 in civil liberties, countries and territories have few partial rights. For example, a country might have some religious freedom, some personal social freedoms, some highly restricted private business activity, and relatively free private discussion. In general, people in these states and territories experience severely restricted expression and association. There are almost always political prisoners and other manifestations of political terror.

7 Rating. At category 7, countries and territories have virtually no freedom. An overwhelming and justified fear of repression characterizes the society.

APPENDIX II

Introduction

This appendix provides further basis of comparison of country performance in the region vis-a-vis countries outside ENI. It includes indicators in economic performance, democratization, and social conditions, and excludes a comparison of economic policy reforms since those data are available for the ENI region only. Also, fewer economic performance and social indicators are used in this analysis than is used in the body of the report since some such indicators are not available for the comparators.

Fifteen comparators across the income per capita spectrum are highlighted. To facilitate comparisons, the raw data are rated on a one-to-five scale, with five representing best performance. The particular scales are specified in the endnotes.

Salient Findings

The comparisons confirm the very wide range in performance across the transition economies, and the large CEE-NIS progress gap (*Summary Tables 1 & 2*). In particular, some CEE countries (the Czech Republic, Poland, and Slovenia, in particular) score an overall rating comparable to some industrial market economies.¹ In contrast, the poorest performers, all in the NIS, score below overall performance standards of the comparators of all income levels. Overall economic, political, and social conditions in Zambia, Ghana, Turkey, and Vietnam rank at the bottom of the comparators assessed. Yet, by these standards, six NIS (Tajikistan, Azerbaijan, Georgia, Kazakstan, Turkmenistan, and the Kyrgyz Republic) rank lower still.

In addition, as one would expect, the high-income comparators generally earn the highest scores among all the countries in the sample in democratization and social conditions. However, the best economic performers are found among the middle-income comparators (S. Korea, Thailand, and Chile) and one low-income comparator (China), and three countries in CEE (the Czech Republic, the Slovak Republic, and Croatia). Economic

¹Overall ratings of the industrial market economies would be higher if the economic policy indicators were brought into the picture since, by EBRD definition of such indicators, a "5" is considered policy adherence comparable to that of the industrial market economies. Still, the basic thrust needs to be that some of the CEE countries are doing very well in these relative terms.

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performance in these three CEE countries is comparable by these standards to that in Thailand and Chile.

Finally, it is interesting to note that the extent of democratic freedoms varies widely among this group of high economic performers (*Figure 1*). China is the extreme outlier in this regard, mixing the best economic performance in the sample with as few democratic freedoms as anywhere in the world.

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Appendix II.**Summary Table 1. ENI Country Rating¹**

	<u>Economic Performance</u>	<u>Democratization</u>	<u>Social Conditions</u>	<u>Average</u>
Czech Rep.	4.1	4.6	4.0	4.2
Poland	3.9	4.6	4.0	4.2
Slovenia	3.9	4.6	(4.2)	4.2
Slovak Rep.	4.1	3.9	4.1	4.0
Estonia	3.9	4.2	3.6	3.9
Hungary	3.3	4.6	3.6	3.8
Bulgaria	3.3	4.2	3.6	3.7
Latvia	3.3	4.2	3.4	3.6
Lithuania	3.3	4.6	3.0	3.6
Romania	3.6	3.2	3.4	3.4
Croatia	(4.0)	2.8	(3.1)	3.3
Macedonia	3.0	3.2	(3.5)	3.2
Albania	3.3	3.2	(2.7)	3.1
Russia	2.9	3.2	2.8	3.0
Belarus	3.3	2.1	3.5	3.0
Moldova	2.9	2.8	3.0	2.9
Armenia	2.5	2.8	(3.1)	2.8
Ukraine	1.8	3.2	3.0	2.7
Uzbekistan	3.5	1.0	(3.0)	2.5
Kyrgyz Rep.	(1.9)	2.8	(2.5)	2.4
Turkmenistan	(3.0)	1.0	3.1	2.4
Kazakstan	2.5	1.8	2.7	2.3
Georgia	(1.9)	2.5	(2.5)	2.3
Azerbaijan	2.3	1.4	(2.7)	2.1
Tajikistan	1.6	1.0	(2.1)	1.6
<hr/>				
CEE & NIS	3.0	3.1	3.1	3.1
CEE	3.7	4.1	3.7	3.8
NIS	2.7	2.7	2.9	2.8

¹On a 1-5 scale with 5 representing the best performance. Elaboration of the ratings is provided in the endnotes of this appendix. The indicators used coincide with those which are available and used for the comparators below. Note the economic policy reform indicators are not included. Parentheses signify that at least one indicator is not included in the average calculation.

Appendix II.**Summary Table 2. Country Rating of Comparators¹**

	<u>Economic Performance</u>	<u>Democratization</u>	<u>Social Conditions</u>	<u>Average</u>
CEE & NIS	3.0	3.1	3.1	3.1
CEE	3.7	4.1	3.7	3.8
NIS	2.7	2.7	2.9	2.8

*Comparators:*Low-income

Vietnam	(3.8)	1.0	(3.3)	2.7
Zambia	(2.6)	3.2	1.7	2.5
Ghana	2.8	2.8	2.3	2.6
China	4.5	1.0	3.0	2.8
Honduras	3.1	3.5	2.5	3.0

Middle-
income

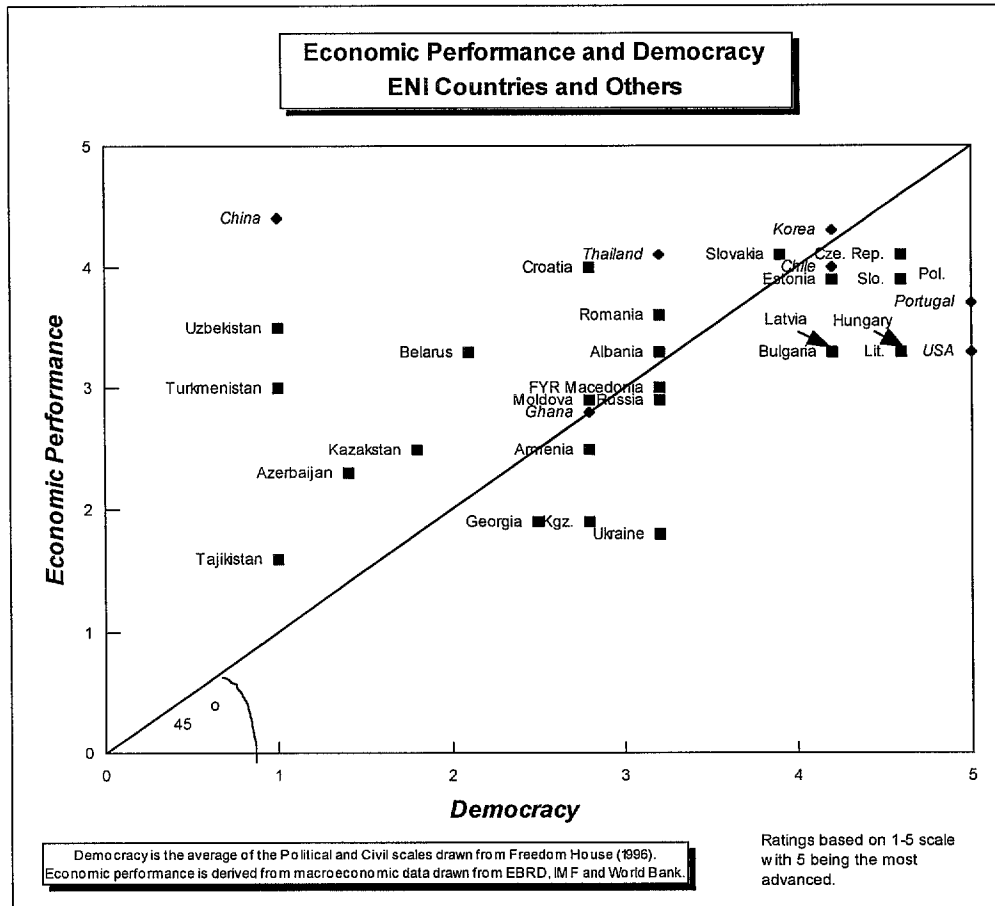
Thailand	4.1	3.2	3.2	3.5
Turkey	3.0	2.1	(2.9)	2.7
Chile	4.0	4.2	3.8	4.0
Greece	(3.1)	4.3	(4.6)	4.0
Korea	4.3	4.2	(4.3)	4.3

High-income

Portugal	(3.7)	5.0	(4.8)	4.5
Finland	(3.1)	5.0	4.5	4.2
Austria	(3.3)	5.0	(4.8)	4.4
Germany	(3.3)	4.6	4.7	4.2
U.S.	(3.3)	5.0	4.5	4.3

¹On a 1-5 scale with 5 representing the best performance. Elaboration of the indicators used is provided in the tables below. Parentheses signify that at least one indicator is not included in the average calculation.

Appendix II
Figure 1



Economic Performance Indicators¹

	1994-96 GDP Growth		1995-96 Inflation		GDI as % of GDP		FDI as % of GDP	
	(%)	Rating ²	(%)	Rating ³	(%)	Rating ⁴	(%)	Rating ⁵
CEE & NIS	-4.6	2	83.5	3	21.7	4	3.3	2
CEE	4.2	4	28.9	3	20.6	4	8.5	3
NIS	-8.1	2	105.4	2	22.1	4	1.2	1

*Comparators:*Low-income

Vietnam	9.1	5	13.1	4	24	4	2.0	2
Zambia	-2.6	2	30.0	3	7	1	13.5	4
Ghana	4.2	4	58.1	3	16	3	1.3	1
China	11.0	5	14.8	4	42	5	30.0	5
Honduras	1.5	3	18.5	4	26	5	6.8	3

Middle-income

Thailand	8.6	5	5.8	5	40	5	7.5	3
Turkey	1.4	3	93.6	3	22	4	2.2	2
Chile	6.4	5	8.2	5	27	5	8.8	3
Greece	1.8	3	9.0	5	18	3	8.1	3
Korea	8.7	5	4.5	5	38	5	1.8	1

High-income

Portugal	1.7	3	3.8	5	26	5	10.8	4
Finland	4.3	4	3.7	5	14	2	4.8	2
Austria	2.5	4	2.1	5	25	4	3.1	2
Germany	2.4	4	1.8	5	22	4	1.4	1
U.S.	2.7	4	2.8	5	16	3	4.8	2

Economic Performance (cont'd)

	Export Growth		Fiscal Balance (% of GDP)		Debt Service (% of Exports)		Current AcctBal. (% of GDP)	
	(%)	Rating ⁶	(%)	Rating ⁷	(%)	Rating ⁸	(%)	Rating ⁹
CEE & NIS	7.4	4	-4.7	3	16.0	3	-2.6	3
CEE	16.8	5	-2.8	3	12.4	3	-2.1	3
NIS	3.6	3	-5.4	2	17.5	3	-2.9	3

Comparators:

Low-income

Vietnam	--	--	--	--	6.1	4	--	--
Zambia	13.7	5	-7.3	2	31.5	1	--	--
Ghana	7.5	4	-2.5	3	24.8	2	-9.0	2
China	16.0	5	-2.1	3	9.3	4	1.4	5
Honduras	1.4	2	3.1	5	33.9	1	-9.7	2

Middle-income

Thailand	14.6	5	1.9	5	16.3	3	-5.9	2
Turkey	7.7	4	-4.0	2	33.4	1	1.7	5
Chile	9.0	4	1.7	5	20.3	2	-2.4	3
Greece	10.4	5	-15.6	1	--	--	-6.3	2
Korea	10.6	5	0.3	5	7.0	4	-1.1	4

High-income

Portugal	1.0	2	-2.2	3	--	--	-1.9	4
Finland	6.6	3	-14.1	1	--	--	1.0	5
Austria	2.6	2	-5.1	2	--	--	-0.8	4
Germany	-3.0	1	-2.5	3	--	--	0.3	5
U.S.	6.7	3	-3.0	3	--	--	-2.1	3

Democratization¹⁰

	Political Rights	Civil Liberties	Average
CEE & NIS	3.2	3.0	3.1
CEE	4.2	4.0	4.1
NIS	2.8	2.5	2.7

Comparators:

Low-income

Vietnam	1.0	1.0	1.0
Zambia	3.5	2.8	3.2
Ghana	2.8	2.8	2.8
China	1.0	1.0	1.0
Honduras	3.5	3.5	3.5

Middle-
income

Thailand	3.5	2.8	3.2
Turkey	2.1	2.1	2.1
Chile	4.2	4.2	4.2
Greece	5.0	3.5	4.3
S.Korea	4.2	4.2	4.2

High-income

Portugal	5.0	5.0	5.0
Finland	5.0	5.0	5.0
Austria	5.0	5.0	5.0
Germany	5.0	4.2	4.6
U.S.	5.0	5.0	5.0

Social Conditions

	Per Capita Income		Current GDP to 1989 GDP		Income Distribution	
	<u>Int'l \$</u>	<u>Rating¹¹</u>	<u>(%)</u>	<u>Rating¹²</u>	<u>Top 20% to Bottom 20%</u>	<u>Rating¹³</u>
CEE & NIS	4,010	2	62	2	8.6	3
CEE	5,780	3	88	3	3.9	5
NIS	3,330	2	52	2	10.7	2

Comparators:

Low-income

Vietnam	--	--	155	5	5.6	4
Zambia	860	1	98	3	12.9	2
Ghana	2,050	1	129	4	5.3	4
China	2,500	1	178	5	7.1	3
Honduras	1,940	1	125	4	15.1	1

Middle- income

Thailand	6,970	3	160	5	9.4	3
Turkey	4,710	2	117	4	--	--
Chile	8,890	4	151	5	17.4	1
Greece	10,930	4	109	4	--	--
Korea	10,330	4	147	4	--	--

High-income

Portugal	11,970	5	105	4	--	--
Finland	16,150	5	88	3	6.0	4
Austria	19,560	5	110	4	--	--
Germany	19,480	5	107	4	5.8	4
U.S.	25,880	5	116	4	8.9	3

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Social Conditions (cont'd)

	Enrollment Ratio ¹⁴		Infant Mortality		Life Expectancy	
	(%)	Rating ¹⁵	(Deaths)	Rating ¹⁶	(Years)	Rating ¹⁷
CEE & NIS	75	4	18.9	3.9	67.6	2.9
CEE	70	4	16.0	4.2	71.2	3.9
NIS	76	4	20.1	3.9	66.2	2.4

*Comparators:*Low-income

Vietnam	51	2	42	2.0	68	3.4
Zambia	49	1	108	1.6	47	1.4
Ghana	45	1	74	1.8	58	1.8
China	57	2	30	3.4	69	3.4
Honduras	61	3	47	2.6	66	3.4

Middle-
income

Thailand	54	2	36	2.5	69	3.4
Turkey	62	3	62	2.0	67	3.4
Chile	71	4	12	4.3	72	4.2
Greece	78	5	8	5.0	78	5.0
Korea	81	5	12	4.3	71	4.2

High-income

Portugal	79	5	8	5.0	75	5.0
Finland	96	5	5	5.0	76	5.0
Austria	85	5	6	5.0	77	5.0
Germany	79	5	6	5.0	76	5.0
U.S.	96	5	8	5.0	77	5.0

1. The ENI regional figures are drawn from the tables in the text; the indicator definitions and sources are the same. The time series for the comparator indicators roughly coincide with the years used to calculate the figures for the transition economies. Latest year available applies to those indicators for which no year is specified.

The primary sources for the comparator data are the appropriate years of the World Bank's: (a) *World Development Report*, (b) *Country Briefs*, (c) *World Tables*, (d) *Atlas*; the IMF's: (a) *World Economic Outlook*, (b) *International Financial Statistics*; Freedom House, *Freedom in the World*; and the UNDP, *Human Development Report*.

2. On a 1-5 scale, 5 is greater than 5%; 4 is 2.1-5%; 3 is 0.1-2%; 2 is -10-0%; and 1 is less than -10%.

3. On a 1-5 scale, 5 is less than 10%; 4 is 10-24%; 3 is 25-99%; 2 is 100-199%; and 1 is 200% or greater.

4. On a 1-5 scale, 5 is greater than 25%; 4 is 20-25%; 3 is 15-19%; 2 is 10-14%; and 1 is less than 10%.

5. On a 1-5 scale, 5 is greater than 20%; 4 is 11-20%; 3 is 5-10%; 2 is 2-4%; and 1 is less than 2%.

6. On a 1-5 scale, 5 is greater than 10%; 4 is 7-10%; 3 is 3-6.9%; 2 is 0-2.9%; and 1 is less than 0%.

7. On a scale of 1-5, 5 is a surplus balance; 4 is -2.0% to 0%; 3 is -5.0% to -2.1%; 2 is -10.0% to -5.1%; and 1 is a deficit balance greater than -10.0%.

8. On a 1-5 scale, 5 is less than 5%; 4 is 10-5%; 3 is 20-10.1%; 2 is 30-20.1%; and 1 is greater than 30%.

9. On a 1-5 scale, 5 is a surplus balance; 4 is -2.0% to 0%; 3 is -5% to -2.1%; 2 is -10% to -5.1%; and 1 is a deficit balance greater than -10%.

10. Freedom House's 1-7 ratings were compressed to a 1-5 scale with 5 representing the most free.

11. On a 1-5 scale, 5 is greater than \$11,000; 4 is \$7,000-\$11,000; 3 is \$5,000-\$6,990; 2 is \$2,500-\$4,990; and 1 is less than \$2,500.

12. On a 1-5 scale, 5 is greater than 150%; 4 is 100-150%; 3 is 70-99%; 2 is 50-69%; and 1 is less than 50%.

13. On a 1-5 scale, 5 is less than 5.0; 4 is 5.0-7.0; 3 is 7.1-10.0; 2 is 10.1-15.0; and 1 is greater than 15.0.

14.The ratio is the combined first, second, and third level enrollment.

15.On a 1-5 scale, 5 is 78-100%; 4 is 70-77%; 3 is 60-69%; 2 is 50-59%; and 1 is less than 50%.

16.This is a composite rating which averages the 1994 infant mortality rate (weighted 80%) and its change since 1991 (weighted 20%). For 1994 infant mortality rate, 5 is less than 10 deaths per 1,000 births; 4 is 10-25; 3 is 26-40; 2 is 41-70; 1 is greater than 70. For the change since 1991, 5 is a decrease or no change; 4 is an increase of 0.1%-5%; 3 is an increase of 6%-10%; 2 is an increase of 11%-20%; and 1 is an increase greater than 20%.

17.This is a composite rating which averages the 1994 life expectancy (weighted 80%) and its change since 1991 (weighted 20%). For 1994 life expectancy, 5 is greater than 74 years; 4 is 70-74; 3 is 66-69; 2 is 60-65; and 1 is less than 60. For the change since 1991, 5 represents no change or an increase; 4 is a decrease of 1% or less; 3 is a decrease from 1.1% to 2%; 2 is a decrease from 2.1% to 3%; and 1 is a decrease greater than 3%.

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